SUPREME COURT, U.S.

TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, [illegible]

No. 55

MANUFACTURERS TRUST COMPANY, AS TRUSTEE UNDER AN INDENTURE MADE BY THE DEBTOR UNDER DATE OF SEPTEMBER [illegible], AND INDIVIDUALLY, PETITIONER,

vs.

EUGENE BECKER, EDITH K. BECKER AND WALTER [illegible]

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED [illegible]

CERTIORARI GRANTED [illegible]

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1949

No. 55

MANUFACTURERS TRUST COMPANY, AS TRUSTEE UNDER AN INDENTURE MADE BY THE DEBTOR UNDER DATE OF SEPTEMBER 27, 1933, AND INDIVIDUALLY, PETITIONER,

vs.

REGINE BECKER, EMILY K. BECKER AND WALTER A. FRIBOURG

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

INDEX

JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., JULY 5, 1949

—3251

[fol. a] [File endorsement omitted]

[fol. 1]

IN UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

In the Matter of CALTON CRESCENT, INC., Debtor

MANUFACTUR ~S TRUST COMPANY, as Trustee under an Indenture made by the Debtor under date of September 27, 1933, and individually, Objector-Appellant,

against

REGINE BECKER, EMILY K. BECKER and WALTER A. FRIBOURG, Claimants-Appellees

Appendix to Appellant's Brief—Filed October 29, 1948

STATEMENT UNDER RULE 15 (b)

This proceeding was commenced by the filing of a petition by the debtor in the United States District Court for the Southern District of New York under Chapter XI of the Bankruptcy Act on May 23, 1946.

The appellees, Walter A. Fribourg, Regine Becker and Emily K. Becker, filed their proofs of claims as creditors [fol. 2] of the debtor on October 28, 1946. The appellant, Manufacturers Trust Company, as indenture trustee and individually, filed its objections to the claims of all three of the above named appellees on December 6, 1946.

A hearing upon the said objections was had before Referee Peter B. Olney on December 30, 1946, January 2, 8 and 20, February 3, March 24, April 10 and May 21, 1947.

On July 2, 1947 the Referee filed his Memorandum of Law and Findings of Fact and Conclusions of Law, disallowing the objections to the aforesaid claims. On July 11, 1947 the Referee entered an order dismissing said objections.

On July 18, 1947 the appellant, Manufacturers Trust Company, petitioned for a review of the order of said Referee which said petition for review came on to be heard before the Hon. Henry W. Goddard, District Judge, on April 21, 1948.

On July 13, 1948, the District Court handed down an opinion affirming the determination of the Referee and on July 21, 1948 an order signed by the Hon. Henry W. Goddard, District Judge, affirming the order of the Referee dismissing said objections was filed.

The appellant's notice of appeal was filed on August 5, 1948.

[fol. 3] IN THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF NEW YORK

No. 84684

In the Matter of CALTON CRESCENT, INC., Debtor

PROOF OF CLAIM OF WALTER A. FRIBOURG *

STATE OF NEW YORK,
County of New York, ss:

Walter A. Fribourg, of 11 West 42nd Street, in City of New York, County of New York, State of New York, being duly sworn, deposes and says:

1. That he hereinafter designates himself as claimant.

2. That Calton Crescent, Inc., the above named debtor, was at and before the filing by said debtor of the petition for arrangement, and still is justly and truly indebted (or liable) to claimant in the sum of $55,000.00.

3. That the consideration of said debt (or liability) is as follows:

Debenture bond issued by debtor in 1933 in connection with a reorganization of debtors property known as Calton Court Apts., said bonds being numbered: D91, D4, M10, D115, M169, M8, L18, C35, C36, M67, [fol. 4] D41, M91, M90, C64, C65, L39, D98, D97, B8, M13, M14, M15, M16, D67, D12, M217, D100, D40,

---

* Similar proofs of claim were made by the other appellees, Regine Becker and Emily K. Becker, their claims being in the amount of $44,500 and $52,800 respectively and being based, of course, upon other debentures of the debtor.

M65, M66, D141, D112, C137, C138, L81, M72, M73, D54, M161, D71, M168, M255, M256, D113, D25, D29, D26, D23, M71, M11, D77, C16, C17, L9, D6, D5, M201, M200, M9, D3, M273, M274, M276, M277, M278, M279, M280, D120, D118, D119, D121, D122, M281, D82, D151, M42, D24, D94, D11, M49, M50, M51, D84.

and actual custody thereof being in claimant.

4. That no part of said debt (or liability) has been paid.

5. That there are no set-offs or counterclaims to said debt.

6. That claimant does not hold, and has not, nor has any person by claimant's order, or to depondent's knowledge or belief, for claimant's use, had or received, any security or securities for said debt.

Walter A. Fribourg.

(Sworn to by Water A. Fribourg, Oct. 28, 1946.)

[fol. 5] In United States District Court

Objection to Claim of Walter A. Fribourg *

[Same Title]

To Honorable Peter B. Olney, Referee in Bankruptcy:

Manufacturers Trust Company, as Trustee under an Indenture made by the Debtor under date of September 27, 1933, and individually, one of the creditors of the Debtor, objects to the allowance of the claim of Walter A. Fribourg filed herein in the amount of $54,500, upon the ground that by reason of the manner and circumstances under which the said creditor acquired the debentures of the Debtor, which are the subject matter of said claim, at prices substantially less than their real value, said claim should be limited to the aggregate of the

* Similar objections to allowance of claims were made to the claims of Regine Becker and Emily K. Becker which were in the respective amounts of $44,500 and $52,800.

amounts actually paid by the said creditor for the said debentures of the Debtor.

And in respect of said objection Manufacturers Trust Company (hereinafter referred to as "Manufacturers") further alleges:

1. Manufacturers is a corporation duly organized and existing under the laws of the State of New York, and has its principal office at No. 55 Broad Street, in the Borough of Manhattan, City and State of New York.

2. Heretofore under an indenture dated February 1, 1928, by and between Empire Bond & Mortgage Corporation and the American Trust Company (thereafter merged with Bank of Manhattan Trust Company on October 30, 1930), the said Empire Bond & Mortgage Corporation issued its so-called First Mortgage 6% Participation Gold Bond Certificates in the principal amount of $575,000 [fol. 6] secured by a first mortgage on the Calton Court Apartments, being an apartment house located in New Rochelle, Westchester County, New York.

3. Thereafter by reason of default in the payment of taxes and monthly instalments on account of principal and interest, a foreclosure proceeding was instituted by the corporate trustee of said mortgage. By reason of such foreclosure proceeding, and on or about April 25, 1932, a protective committee for the holders of said Gold Bond Certificates was organized and Manufacturers was named and acted as depositary for said committee.

4. Thereafter under date of July 1, 1933 a plan of reorganization was promulgated by said committee and in pursuance of said plan, on September 8, 1933, the said premises were sold at foreclosure and bid in by the committee for the sum of $93,000. At the time of the sale unpaid taxes, penalties and liens, other than the lien of the mortgage, aggregated in excess of $91,000. In payment of the amount bid upon the sale, the committee delivered to the corporate trustee $513,600 face amount of said Gold Bond Certificates deposited with the committee.

5. In further pursuance of said plan, the Debtor herein was organized to take title to said premises.

6. It was provided by the plan that the New Company (the Debtor) would create an issue of debentures in a

principal amount aggregating 50% of the principal amount of certificates deposited or which should be deposited with the committee, such debentures to be issued in denominations of $50, $100, $500 and $1,000, to be registered as to both principal and interest, to be dated as of the date of delivery of the deed by the referee in fore-
[fol. 7] closure to the New Company, and to mature twenty (20) years from the date thereof. It was further provided that said debentures should bear interest at a rate not exceeding six percent per annum as the directors in their sole discretion should declare out of the net earnings of each calendar year.

It was further provided that under the plan of reorganization each assenting depositor should receive $50 of such debentures and one share of no par value stock of the New Company for each $100 principal amount of the certificates of deposit, and that no debentures or stock should be issued except to such depositors.

7. Thereafter and on September 27, 1933 said premises were duly conveyed to the Debtor and said Debtor entered into an indenture with Manufacturers as Trustee, proving for the issuance of its debentures provided for in the plan. Said indenture continues in force and effect, and the Manufacturers has at all times acted and is still acting as trustee thereunder.

8. In pursuance of said plan and under the terms of said indenture there were issued and are outstanding $254,450 principal amount of said debentures, and there remain unexchanged $4,700 principal amount of certificates of deposit, convertible into $2,350 principal amount of such debentures, or a total authorized of $256,800 principal amount of debentures.

9. At the time of the issuance of the securities of the Debtor in pursuance of the plan and indenture, there were 205 holders of outstanding certificates or deposit.

10. In further pursuance of the plan, the Debtor borrowed the sum of $175,000 from Poughkeepsie Savings
[fol. 8] Bank of Poughkeepsie, New York, secured by a first mortgage on the said premises, upon which mortgage there is now due and unpaid the sum of $154,000 principal amount.

11. In pursuance of the provisions of the plan, the first directors of the Debtor were selected by the said

committee, and said directors in turn elected its first officers. In consequence the management of the Debtor was, as contemplated by the plan, for the benefit of the holders of Mortgage Certificates of Empire Bond & Mortgage Corporation, who had elected to deposit their certificates and to participate in the plan.

12. From time to time beginning in September, 1941, debentures of the Debtor were acquired by or for the benefit of five individuals or some of them, to wit, Sanford Becker, Norman S. Becker, Walter A. Fribourg, Emily K. Becker and Regine Becker. Said Sanford Becker and Norman S. Becker are brothers, and they and said Walter A. Fribourg share the same office space and are or have been jointly interested in various business ventures, particularly matters involving real estate. Said Emily K. Becker is the wife of said Sanford Becker and said Regine Becker is the mother of said Sanford Becker. The claimant to whose claim this objection is filed is the same as the person of that name forming one of the said group.

13. The said debentures so acquired by members of said group aggregate the principal amount of $156,800, which are nominally held as follows (including the claim here objected to):

[fol. 9]	Sanford Becker	$ 5,000
	Emily K. Becker	52,800
	Regine Becker	44,500
	Walter A. Fribourg	54,500

14. In April 1942 the Debtor placed a second mortgage upon the said premises in the face amount of $15,000, the mortgagee being one Baset Realty Corporation. This mortgagee was a corporation organized at that time, for which the capital was supplied by said Beckers and Fribourg or members of their families. Thereafter, in October, 1943, the Debtor made an assignment of rents to said Baset Realty Corporation, and said corporation thereupon went into possession of the property, and collected the rents and income therefrom and continued in possession of the property until the sale thereof as hereinafter set forth.

15. In or about April 1942, and at or about the time of the making of said mortgage to said Baset Realty Cor-

poration, said Sanford Becker and Norman S. Becker became directors of the Debtor, Norman S. Becker became Secretary and Sanford Becker became Treasurer of the Debtor, and the offices of the Debtor were thereafter maintained at the offices of the said Beckers. Subsequently, in or about May 1944, said Norman S. Becker became President of the Debtor. The other officers and directors of the Debtor resigned, and the Beckers, their family and said Fribourg thereupon came into control of the Debtor.

16. During the years 1944, 1945 and 1946 the said members of the Becker family and the said Walter A. Fribourg acquired a substantial principal amount of debentures and corresponding stock of the Debtor from public holders of [fol. 10] said securities at prices ranging from approximately 3% to 14% of the par value of the debentures so acquired, and said debentures were so acquired from such public holders thereof at times when the holders of such debentures were not being supplied with fair and adequate financial information as to the affairs of the Debtor, and without disclosing to said holders (a) the identity of the purchasers thereof; (b) that such purchasers were in control of the corporation; (c) that the Baset Realty Corporation, the second mortgagee in possession, was owned and controlled by some or all of said members of the Becker family; (d) that from time to time offers were being received for said property at prices which would leave for the debenture holders an equity substantially in excess of 14% of the par value of their debentures; and (e) that it was known to such purchasers that there was imminent or had been executed a contract for the sale of the Debtor's property, which would result in cash and purchase money mortgage proceeds sufficient to leave an equity for the debenture holders of about 40% of the par value of the debentures.

17. Debentures upon which the claim here objected to was filed consist in whole or in part of debentures so purchased under the circumstances above set forth.

18. In October 1945 the Debtor made a contract for the sale of said premises, and thereafter and in pursuance of such contract said property was conveyed on January 8,

1946 to one Calton Properties, Inc. for a total sales price of $300,000, paid as follows:

> Subject to the said first mortgage to the Poughkeepsie Savings Bank in the then unpaid principal [fol. 11] balance of $154,000; by cash of $70,000 and by purchase money mortgage to the Debtor of $76,000.
>
> From the proceeds of said sale, the Debtor satisfied the second mortgage to Baset Realty Corporation and paid a brokerage commission of $6,000, leaving cash remaining from the said proceeds of sale of approximately $50,000.

Said sale was made without the knowledge or consent in writing or otherwise of Manufacturers.

19. Said purchase money mortgage was thereafter sold pursuant to an order of this Court for the sum of $66,000, resulting in a total cash in the possession of the Debtor of $118,662.17 prior to administration expenses.

20. By further order of this Court entered upon confirmation of the amended plan of arrangement herein there were directed to be paid to the general creditors, including the debenture holders of the Debtor, amounts equivalent to 43 61/100% of the principal amount of their claims.

21. To permit the creditor to whose claim this objection is filed to receive a minimum dividend of 43 61/100% upon said creditor's claim is inequitable, inasmuch as some or all of the debentures held by said creditor upon which said creditor's claim was filed were acquired by said creditor for amounts ranging from 3 to 14% of the face amount of said debentures when said creditor belonged to a group in control of the affairs of the Debtor and failed to make fair and full disclosure to the holders from whom such debentures were purchased of all of the facts and circumstances as hereinbefore set forth.

[fol. 12] Wherefore, Manufacturers Trust Company prays that said claim be disallowed except to the extent of the aggregate of the amounts actually paid by the said creditor for the debentures upon which said claim is made, and for such other and further relief as is just.

Dated: December 6, 1946.

Manufacturers Trust Company, Creditor-Objectant.
By Frank P. Gage, Trust Officer.

Beekman & Bogue. By Edward K. Hanlon, a Partner, Attorneys for Creditor-Objectant, No. 15 Broad Street, New York 5, New York.

(Verified by Frank P. Gage, Dec. 6, 1946.)

[fol. 13] IN UNITED STATES DISTRICT COURT

Extracts from Stenographic Minutes of the Hearing Before Referee Olney

[Same Title]

EXTRACTS FROM TESTIMONY OF SANFORD BECKER

Page 28*

By Mr. Hanlon:

Q. In the course of this proceeding, Mr. Becker, your brother made an affidavit, a copy of which I have here which was served on me, which was verified on June 18, 1946, and I read you the following sentence from that affidavit which you can see as I read it:

> "My brother, Sanford Becker, in September, 1941 purchased in the open market five thousand of such debentures at the prices then prevailing."

A. I believe the date is correct;

* * * * * * *

Pages 35-38

By Mr. Hanlon:

Q. Coming back to the minutes and the discussion which I just read you from those minutes of the meeting on January 30, 1942 you will notice that Mr. Fribourg made reference to a stockholders' suit?

A. That is correct.

Q. Were you a party to that suit?

A. I was the plaintiff, the only plaintiff.

---

* Page references are to the paging of the Stenographer's Minutes.

Q. Where was that stockholders' suit?

A. I would not know.

Q. In which court?

A. I would not know that.

[fol. 14] Q. You do not know in which court it was, although you signed the papers?

A. I sign any papers that lawyers give me. But I do not know in which court.

(General discussion followed.)

The Referee: Go ahead.

Q. What was the status of that suit when this meeting was held on January 30, 1942?

A. The suit was for the purpose of an injunction to prevent the sale.

Q. What was the status of the suit, at what point had the suit arrived at the time of this meeing on January 30, 1942?

A. I don't know.

Q. All you remember now is that you had brought the suit?

A. That is right.

Q. What was the basis upon which you objected to the sale as set forth in the papers filed in that suit?

A. That I believed the price to be inadequate and that if it were liquidated there would be nothing for stockholders, that if the corporation were able to continue eventually they would receive more.

Q. Did you make any statement as to what you believed a fair appraisal of the property would show?

A. When I say "statement" I am referring now to the Court papers. I don't know; I may have.

Q. Didn't you make a statement in those papers that the property was worth at least what the Poughkeepsie Savings Bank had appraised it at?

A. I don't know.

Q. You have no present recollection?

A. I don't remember what the appraised figure was.

Q. But you do remember that you felt that that $220,000 was not enough money for this property in 1942?

A. I do know at that time my opinion was that if they sold it for two hundred and twenty they would receive nothing, [fol. 15] so the best thing they could do would be to stay in business.

Q. Didn't you make an allegation in those papers which you signed as to the value of the property, in those court papers?

A. I may have; I don't know. If you have a copy of it, I could tell you very quickly.

Q. I don't have a copy of them.

A. I don't either.

Q. Do you recollect whether in connection with that same case that you brought as a stockholder answering affidavits were furnished in respect to the injunction suit by your brother Norman and Mr. Fribourg?

Mr. Kahn: I am sorry, I did not get that question.

Mr. Hanlon: I said did he recollect that answering affidavits were furnished by his brother Norman Becker and Mr. Fribourg.

A. I don't know.

Q. And you have no copies of the papers in that case?

A. No, sir.

Q. Did you make any investigation at that time by way of getting an appraisal or otherwise as to the value of the apartment house?

A. No.

Q. You said you yourself were not a real estate man?

A. No, I am not.

Q. So I am stumbling along from that and trying to find out as to whether you made any inquiry as to that?

A. I may have; I don't remember. It is a long time ago.

Q. All you remember now is that you objected to a sale and brought suit?

A. That is right.

Q. And you stand by any statement that you made in those suit papers?

A. Naturally.

• • • • • • •

[fol. 16] Page 48

By Mr. Hanlon:

Q. Mr. Becker, you recollect that the proposal to sell this property for $220,000 to this proposed purchaser, the Chesterbrook Estates, Ltd., finally came to a vote of the stockholders?

A. I believe so.

Mr. Hanlon: May it appear on the record, so that we will not have to put the minutes in, that this came to the attention of the stockholders at an adjourned meeting held on February 17, 1942; that the affirmative vote in favor of the sale was 3,326 shares—I beg your pardon, it was 3,083 shares, which was short of the requisite two-thirds.

Q. So that the proposal was not carried; is that correct, Mr. Becker?
A. That is correct.

• • • • • • •

Pages 50-52

By Mr. Hanlon:

Q. In this letter, Mr. Becker, you say this:

"Providing the necessary legal stockholders' approval is obtained, a client of mine has offered to loan to Calton Crescent, Inc. a sum necessary to clean up all of the dividends" and so forth.

When you spoke of "a client" of yours to whom were you referring?
A. I was then referring to my wife, my mother and Walter A. Fribourg.
Q. Your wife being——
A. (Interposing) Emily K. Becker.
Q. And your mother being Regine Becker?
A. That is right.
[fol. 17] Q. This offer was accepted, was it not, Mr. Becker?
A. Yes.
Q. And the execution, the delivery of the mortgage, was authorized at this annual meeting of stockholders held on February 17, 1942?
A. Yes.
Q. The loan of $15,000 actually was made by one Baset Realty Corporation, wasn't it?
A. That is correct.
Q. What was the Baset Realty Corporation?

The Referee: What do you mean, "what was it"?

Q. (Continuing) When was it organized, Mr. Becker?
A. I don't know.

The Referee: He has admitted in the stipulation that the capital was supplied by—(interrupted by)

Mr. Kahn: That is correct.

Mr. Hanlon: I did not know he admitted it.

The Referee: I have a note of it.

Q. This was a corporation, the Baset Realty Corporation, organized by your mother, your wife and Mr. Fribourg in New York?

A. No.

Q. When was it organized?

A. It was organized by Mr. Eisenberg to complete this transaction.

Q. Mr. Eisenberg, your lawyer, organized the Baset Realty Corporation?

A. Yes.

Q. Who were the stockholders?

A. I don't know.

Q. Who advanced the money to the corporation to enable it to make the loan of $15,000 to the debtor?

A. The three individuals whom I mentioned.

Q. That is, your mother——

[fol. 18] The Referee: What did they get; did they receive notes of the corporation?

The Witness: They got the mortgage.

The Referee: Who got the mortgage?

The Witness: The three individuals.

The Referee: Baset did not get the mortgage?

The Witness: No. They were merely a depository for it.

The Referee: Did Baset assign the mortgage to these three individuals?

The Witness: Yes.

Q. In other words, as I understand, the mortgage was assigned originally from Baset Realty Corporation?

A. Yes.

Q. Which in turn—(interrupted)

A. They gave participation in the mortgage to those three individuals.

The Referee: That is something else again.

The Witness: I don't know what the legal details was.

The Referee: To what extent did they give participation?

The Witness: One-third each.

• • • • • • •

Page 57

By Mr. Hanlon:

Q. Was it one of the requirements for the lending of the $15,000 by Baset or through Baset that Baset had the right to elect two directors of the debtor?

A. Yes.

The Referee: Of the debtor?

Mr. Hanlon: Yes.

[fol. 19] The Referee: That was the subject matter of a directors' meeting, of directors' action by the debtor corporation, was it?

Mr. Hanlon: It came up at such a meeting.

The Referee: That is what I wanted to find out.

The Witness: Yes, sir.

The Referee: Whether it was pursuant to action of the board of directors.

Q. Thereafter, Mr. Becker, it came to pass, on April 7, 1942, that this mortgage transaction was closed, was it not?

A. Yes.

• • • • • • •

Pages 68-72

Mr. Hanlon: In response to my question of a moment ago Mr. Becker has indicated to me in the minutes of the annual meeting of stockholders held on February 17, 1942 the following paragraph which I will read for the record (doing so):

> "Mr. Amend stated that he had conferred with Mr. Eisenberg and that Mr. Becker would be willing to loan $15,000 on second mortgage provided he be given the right to designate a majority of the board of directors and the right to appoint the managing agent, and Mr. Becker stated that he would increase the offer of the mortgage loan in his letter to $15,000 accordingly."

Q. Is that the statement you indicated?

The Referee: That refers to this Becker, Sanford Becker?

[fol. 20] Q. That refers to you, Mr. Becker?

A. Yes. It was in that conversation that I told him.

Q. I ask you where in the minutes it is shown?

A. That is in reference to that conversation. The minutes refer to a conversation I had with Mr. Amend and Mr. Eisenberg in which conversation I told them who the parties were that were participating in the loan.

Q. My question was directed to the meeting of the stockholders.

A. I stated it at the open meeting, too.

The Referee: You stated it at the open meeting, but it is not in the minutes of the meeting; is that what you want to say?

The Witness: Yes. There was a lot of conversation; the meeting lasted four or five hours and not one-tenth of it is in the minutes.

(Further colloquy followed.)

Q. Returning to the meeting of the directors held on April 7, 1942, during the course of which your Honor will remember this mortgage transaction was closed, the minutes correctly state, do they not, Mr. Becker, that you and your brother were elected directors at that meeting?

A. I believe it was at that meeting.

~~Q. Well, aren't you sure?~~

A. I believe it was.

The Referee: According to the statement you made at the stockholders' meeting you made it a condition of the loan that you be permitted to have a majority on the board?

The Witness: Yes.

The Referee: Who was the third one?

The Witness: We waived that afterwards; it was changed afterwards so that only two members of the board were designated.

[fol. 21] Mr. Kahn: Two members what?

The Witness: Only two members of the board were designated.

The Referee: How many members were there; five?

The Witness: There were at least five.

The Referee: Did you designate also the managing agent?

The Witness: Yes, we did.

The Referee: Who was that?

The Witness: That was the Westchester Trustees.

Q. Is that the full name?

A. Westchester Trustees.

Q. Who are they?

A. They are a co-operative agency which managed a good many of the issues in Westchester County for the courts.

Q. You have no interest in Westchester Trustees, have you?

A. None whatsoever.

Q. Nor your brother nor Mr. Fribourg?

A. None whatsoever.

Q. Returning again to this letter of April 7th when you and your brother were elected as members of the board you were so elected as the designees of Baset Realty Corporation, the second mortgagee?

A. Yes.

Q. In pursuance to your understanding?

A. Yes.

Q. At the same meeting it is stated that you were elected treasurer of the debtor and your brother secretary, is that correct?

A. If the minutes state it. I don't remember.

Q. But you did at or about that time become treasurer and your brother did become secretary of the debtor, did he not?

A. My recollection is it was some time later.

Q. I show you the minutes, and if it so states you will not dispute it, will you?

A. No, no.

[fol. 22] Mr. Hanlon: It is right at the top (indicating).

(Further colloquy followed.)

Q. Referring further to the board of directors' meeting of April 7, 1942, I read the following from Objectant's Exhibit 8:

> "On motion duly made and seconded, it was unanimously resolved that the principal office of the corporation be fixed at the office of the treasurer, Room 2346, No. 11 West 42nd Street, in the Borough of Manhattan, City of New York."

You recollect the adoption of that resolution?

A. Yes.

Q. And when it speaks of "the office of the treasurer" at the room and address which is mentioned, does it refer to your office?

A. Yes.

Q. And did it thereupon ensue that the office of the debtor was transferred to your office?

A. Yes.

Q. And thereafter maintained there until the present time?

A. Yes.

• • • • • • •

Page 74

By Mr. Hanlon:

Q. Mr. Becker, subsequently on June 28, 1944, three directors who then held office, other than your brother and yourself, resigned, did they not?

A. What date?

Q. The date that I have is June 28, 1944. The precise date is not important. Was it on or about that time?

A. I don't know the exact date.

Q. But they did——

A. (Interrupting) They did resign.

Q. Who were those three directors who resigned?

A. My recollection is they were Richard Kelly, Henry Hays and Mr. Clay; that is my recollection.

• • • • • • •

[fol. 23] Pages 74-77

By Mr. Hanlon:

Q. Who were the directors who were elected in their place?

A. I don't know. The minutes will state. I don't remember.

Q. Well, looking at the minutes of the annual meeting on February 20, 1945, which was subsequent to the time as to which I have been questioning you, I find that they elected at that meeting yourself and your brother, Mr. Alvin Lichtenberg and Mr. Edward Hennefeld. Were those two of the directors who were elected in the previous summer when these gentlemen you mentioned resigned?

A. Yes, yes.

Q. Does that help you to recall who the fifth director was who was elected on that occasion?

A. No, I don't know who the fifth director was.

Q. Who is Mr. Lichtenberg?
A. Who is Mr. Lichtenberg?
Q. Yes.
A. Mr. Lichtenberg is a friend of mine.
Q. Is he in business with you?
A. No.
Q. Was he a stockholder of the debtor?
A. No.
Q. He was elected a director of the debtor and served at your request?
A. That is correct.

The Referee: At whose request?
Mr. Hanlon: At Mr. Becker's request.
The Referee: This witness?
Mr. Hanlon: Yes. Mr. Becker testified Mr. Lichtenberg was a friend of his.

Q. Now, who is Mr. Hennefeld?
A. He was also a friend of mine.
[fol. 24] Q. Was he a security holder of the debtor?
A. I don't believe so.
Q. And he likewise served as a director of the debtor at your request because he was a friend of yours?
A. That is right.

The Referee: What particular qualifications did they have for being directors, except being a friend of yours?
The Witness: They have no particular qualifications, except that we could not get any one else to serve; no one else would serve.
The Referee: What was the reason for that, if you know?
The Witness: Because the corporation was bankrupt, it had no assets of any kind and was heavily in debt, and no one wanted to be associated with it.

Q. You say you do not remember the name of the fifth director who was elected in June, 1944?
A. No.
Q. I find it at a later date one Ann Priskie was serving as a director?
A. Yes. She is my secretary.
Q. Was she one of the board of directors elected in June, 1944?
A. Probably, yes.

The Referee: At your request?
The Witness: At my request, yes.

Q. Was she a securityholder?
A. No.
Q. And did she continue to function from June, 1944 to the present time?
A. If the minutes so state I believe so, yes.

The Referee: That was the whole board, the five members?
[fol. 25] The Witness: The five members.
The Referee: Your brother, yourself, Mr. Lichtenberg and this other man, and your secretary?
The Witness: Yes.

• • • • • • •

Page 78

By Mr. Hanlon:

Q. Now, on October 19, 1943 it is admitted, as I understand it, that the debtor made an assignment of rents to the Baset Realty Corporation?
A. Yes, sir.
Q. Now, what occurred after the debtor made the assignment of rents to the Baset Realty Corporation with respect to the management of the property, the collection of its income and so on?
A. The mortgagee in possession retained the managing agent to manage the building.

• • • • • • •

Pages 78-79

By Mr. Hanlon:

Q. When did you become president of the debtor corporation?
A. I never became president.
Q. Who is the president; your brother?
A. My brother is, yes.
Q. When did he become president?
A. I don't remember.
Q. Was that at the same time the other three directors went out?
A. Probably.

• • • • • • •

Pages 89-91

By Mr. Hanlon:

Q. Now, in between the offer in respect to which your suit was brought and the sale which was consummated last [fol. 26] year were any other offers made and received by the debtor corporation for the apartment property?
A. No legitimate offers.

Mr. Hanlon: Your Honor, I would ask that the answer be stricken. I asked him whether any other offers were made.
The Referee: What did he say?
Mr. Hanlon: "No legitimate offers."
Mr. Kahn: I think that is a perfectly proper answer.
The Referee: Strike the answer.
Were there any offers made at all?
The Witness: Yes, sir.

Q. What offers were made?
A. Some verbal offers were made by brokers, which were not legitimate offers.

Mr. Hanlon: Now I ask to strike that out again, your Honor.
The Referee: Strike out "which were not legitimate offers". I don't know why we have to take his characterization of the offers.

Q. What offers were received from brokers that you just referred to?
A. A broker came in and said he thought he could get $240,000. I asked him to submit the offer in writing, and that is the last I heard of it.
Q. Who is that broker?
A. I don't even remember the names.
Q. When was it that the broker came and made that statement, approximately?
A. Oh, they came in continuously.
Q. How frequently would you say?
A. I should say once a month at least.
Q. You had brokers coming in?
A. Yes.
[fol. 27] Q. What was the range of the figures these brokers suggested that they thought they could get?
A. All about the same figures.

Q. In the neighborhood of two hundred and forty thousand?

A. Two hundred thirty, two hundred forty, somewhere in there.

Q. Did any of them go higher?

A. Not that I remember.

Q. How many offers would you say, using the word to cover for the moment these verbal proposals, would you say that you received in the course of the past three years; that would be the years to which I referred: for 1943, 1944 and '45?

A. I couldn't say.

Q. But they were on an average of once a month?

A. I should say so.

• • • • • • •

EXTRACTS FROM TESTIMONY OF WALTER A. FRIBOURG

Page 98

By Mr. Hanlon:

Q. Your office is presently maintained in the office of Mr. Sanford Becker and Mr. Norman Becker?

A. No. I have a desk there.

Q. For which you pay them some sort of desk rent?

A. That is correct.

Q. How long have you been at that location?

A. About six years.

Q. That is at 11 West 42nd Street?

A. Yes.

Q. Now, the Beckers have had two different rooms consecutively in that building, haven't they?

A. That is correct.

Q. How big a space is it that you have there?

A. I have no space; I just have a desk there.

[fol. 28] Q. Have you a room for yourself?

A. No, sir.

Q. Are you in a room with others?

A. Yes, sir.

Q. In which office?

A. With Mr. Norman Becker.

Q. Physically you and Mr. Norman Becker share one room?

A. Yes, sir.

Page 99

By Mr. Hanlon:

Q. Do you remember a lawsuit that Mr. Sanford Becker brought against the directors of the debtor and the debtor itself in which he asked for damages?

A. I heard of it.

Q. And asked for the appointment of a receiver?

A. Yes.

Q. And sought to enjoin the sale of the property which was then contemplated?

A. Yes, sir.

Q. Did you have anything to do with that lawsuit?

A. I had nothing to do with it, no, sir.

Q. You knew it was going on?

A. Yes, sir, I did.

Q. By any chance did you make an affidavit in that lawsuit?

A. I heard so, yes, sir, that I did.

• • • • • • •

Page 120

Mr. Hanlon: While the appropriate number of (shares of) stock need not necessarily be acquired with the debentures, I assume under these schedules, unless the contrary be understood in each specific case, that in case of the debentureholders shown on this schedule there was also received by the purchaser the appropriate number of (shares of) stock?

Mr. Kahn: Yes, that is correct.

• • • • • • •

[fol. 29] Extracts from Testimony of Walter A. Fribourg

Pages 126-128

By Mr. Hanlon:

Q. When you purchased these $7,000 principal amount of securities through Reiley & Company you were aware, were you not, that the Baset Realty mortgage had been closed; in other words, that the money had been advanced and the mortgage made?

A. In August?

Q. In July and August.

A. Oh, yes, certainly.

Q. And that Mr. Sanford Becker and Mr. Norman S. Becker had become officers and directors of the debtor?

A. Well, if they had I knew when they were. I don't know——

Q. Whenever it was, you knew that?

A. Whenever they became directors I knew that, yes, sir. I don't know when it was.

Q. And that the office of the debtor had been moved to the office of the Beckers, you knew that at that time?

A. I think so, yes.

Q. In other words, whatever the facts were at that time you were informed of them?

A. I knew about them.

Q. You knew at that time then that Mr. Sanford Becker was secretary of the corporation?

A. Well, I don't know what he was. He was an officer I think.

Q. Whatever he was?

A. Whatever he was I knew about it. I don't remember the time.

Q. You knew, Mr. Fribourg, that the minute books and records of the corporation were then at 11 West 42nd Street?

A. I did not know that, but it is logical that they would be if that was the office of the corporation.

Q. Did you at any time during this period see any financial books of the corporation?

A. No, sir.

Q. Did you at this time discuss with Mr. Norman Becker [fol. 30] or with Mr. Sanford Becker the financial affairs of the corporation?

A. Not to any extent.

Q. You did to some extent, didn't you?

A. I don't think so, not to any extent.

Q. Well, by this time—and by that I refer to August 5, 1942—you had acquired $12,000 in principal amount of debentures and the appropriate accompanying stock?

A. That is right.

Q. With that in mind, I ask you again is it your recollection that you did not discuss the affairs of the debtor to any extent with either of the Beckers?

A. No, I don't think so; to any extent, no. I may have asked how they were getting along and they answered.

Q. Did you get any figures from them as to operations?

A. I don't think so, sir.

Q. Did you have any discussion with them as to the substitution of the Westchester Trusts as agent in place of the agent who had theretofore handled the apartment house?

A. Was it at that time——

Q. Yes.

A. (Continuing) That the change was made?

Q. Yes.

A. Then I knew about that.

Q. You discussed that with them?

A. I did not discuss that with them. They said they were going to do that—they thought that was the right people to handle it.

Q. Which one of them said it?

A. One or the other; I can't remember that sir.

Q. You can't remember that because you did have at various times conversations with one or the other with respect to the debtor?

A. That is right.

* * * * * * *

[fol. 31] Pages 129-133

By Mr. Hanlon:

Q. The schedule shows further than on May the 25th, 1944 you purchased $8,250 in principal amount of these securities from Richard Kelly for $247.50.

Mr. Richard Kelly was a president of the debtor, was he not?

A. That is right.

Q. Do you remember the circumstances in connection with that purchase?

A. Well, they were sent in to the Corn Exchange Bank.

Q. Did you yourself discuss the proposition with Mr. Kelly?

A. No, sir.

Q. You had no talk with him whatsoever?

A. No, sir.

Q. You say they were sent in to the Corn Exchange Bank. For whose account?

A. Our account.

Q. Who is "our"?

A. That was—it was in the name of Winter, Charles Winter.

The Referee: It was in the name of who?

The Witness: Charles Winter.

Q. Charles Winter is a brother-in-law of yours; is that right?

A. That is correct.

Q. And he was your brother-in-law at that time?

A. Yes.

Q. What is the business of Charles Winter?

A. Charles Winter, he had real estate and at that time he was with Julius Grossman; but he had outside interests, I think. I don't know exactly what it was, but he was interested in some real estate; I really don't know what. I know he had stocks. I think he was a rich man. His mother was wealthy before him.

Q. When you spoke of "our account" at the Corn Exchange, was it the account of yourself and Mr. Winter?

[fol. 32]

A. No; it was in Mr. Winter's name.

Q. Whose money was it?

A. It was my money.

Q. Was it all your money?

A. Yes, sir.

Q. Until Mr. Kelly's debentures and stock were received and paid for at the Corn Exchange Bank did you know that Mr. Kelly proposed or contemplated selling them?

A. Yes, I am sure—(interrupted)

Q. In what way did that knowledge come to you?

A. I think Mr. Becker told me.

Q. Which Mr. Becker?

A. Either one, I think; I don't know which.

Q. What was it Mr. Becker told you?

A. Well, he told me that Mr. Kelly—now let me see—, Mr. Kelly was willing to sell his bonds, he wanted to sell his bonds because he was, as I think of it now, he was disgusted with the situation; and I said, I think I said, "Well, listen here. I will gamble if I buy mine".

Q. It was before or after the account was opened at the Corn Exchange Bank?

A. I think that was before.

Q. How long before would you say?

A. I can't remember, sir.

Q. Now let me show you——

The Referee: When was this; 1944?

Mr. Hanlon: In '44, your Honor, yes.

Q. (Continuing) Let me show you a copy of a letter addressed to Calton Crescent, Inc. by Charles Winter, dated May 2, 1944, and ask you if you have any recollection of that letter?

A. Well, if this is the offer, yes. We made an offer.

Q. There is no question about that being a copy?

A. I imagine that is right.

[fol. 33] Q. You recollect that document?

A. I remember the letter that was sent out or sent to him.

The Referee: Who?

The Witness: From Mr. Winter to Mr. Kelly, is it? Or, to the Calton Crescent.

Q. It is addressed to the Calton Crescent, Inc.

A. That is right. That is the letter, sure. Just let me look at it again to make sure. (After perusing same) Yes, that was an offer made.

Q. And you knew at that time that the offer was being made?

A. That is right, yes.

Mr. Hanlon: I offer that in evidence, your Honor.

The Referee: Is there any objection?

Mr. Kahn: No.

(The same was received in evidence and marked, "Objectant's Exhibit 14" of this date.)

Q. Before Mr. Winter wrote this letter which has been marked Objectant's Exhibit 14 I suppose he discussed it with you?

A. Yes.

Q. It refers in the letter, for example, to the fact that the Corn Exchange Bank Trust Company, Grand Central branch, will honor sight drafts. I assume that before this letter was sent you had arranged for the bank account to which you referred a moment ago?

A. Well, I don't know whether it was before; but it was done so if anything came in it was taken care of.

Q. In other words, you furnished Mr. Winter with the funds to pick up any securities?

A. That is right.

Q. (Continuing) Which might be received in response to this letter?

A. That is correct.

[fol. 34] Q. And those funds were deposited in the Grand Central branch of the Corn Exchange Bank?

A. That is right.

Q. Did you have anything to do with the composition of this letter?

A. I think I did. I will have to see it. I think I did.

Q. Can you tell me to which parts of the letter you contributed?

A. I don't know. My interest is I will purchase.

• • • • • • •

Pages 135-140

By Mr. Hanlon:

Q. Prior to the writing of this letter by Mr. Winter and yourself, signed by Mr. Winter, did you consult with either of or discuss this with either of the Beckers?

A. I think so.

Q. Well, now, just try to remember which one you talked about it to?

A. Well, that I wouldn't— I can't tell.

Just a supposition: the thought I have in my mind is that I think I talked it over with Sanford. I am not sure, though.

Q. You may have talked it over with both of them; is that correct?

A. I don't think so; I think I talked it over with Sanford.

Q. What discussion did you have with Sanford?

A. Well, to my best recollection I think that he said, "Would you be interested to buy at a low price, because there isn't much there and it does not look so good", or something like that; and I said, "Well, I will gamble".

I think he told me that Mr. Kelly was kind of disgusted with the situation and he wanted to get out, and he would sell his stock—whatever he had—, bonds; and would I

[fol. 35] be interested in it? I said, "Well, I would be interested in a price, at a price".

Q. Is that all there was to the discussion?

A. I think so, yes.

Q. Was there a price discussed?

A. Yes, I think it was.

Q. And what was said about that?

A. I don't remember, I can't remember. I know some—— It finally came out at three. But I don't remember what it was.

Q. At what point was the three percent or the price of three as you put it, reached?

A. How was it reached?

Q. Where, at what point; shortly before this letter was written or some days?

A. Oh, it must have been before that lettter.

Q. I say shortly before.

A. That I would not know.

Q. That was reached in one of your discussions to the best of your recollection with Sanford Becker?

A. With respect to my recollection that would be Sanford.

Q. Who suggested that you not only purchase Mr. Kelly's eight thousand five hundred principal amount but also make a proposition, as you did, through Winter to purchase from other securityholders; who made that suggestion?

A. I would not know that, sir. I may have made it myself. I said if I was going to gamble I might just as well gamble—— It was not a tremendous outlay of money.

Q. Would you say that Mr. Sanford Becker did not make that suggestion?

The Referee: The figure you mean?

Mr. Hanlon: No; from purchasing from others than Richard Kelly.

A. I don't know. I may have made that.

Q. To Mr. Becker?

A. Yes.

[fol. 36] Q. And that was the subject of discussion?

A. I don't know what you mean by "discussion".

Q. I mean you and Mr. Becker talked that over?

A. I think so.

Q. Did Mr. Becker say anything about taking that suggestion up with Mr. Kelly?

A. I think he did.

Q. What did he say?

A. You mean what did Mr. Kelly——

Q. No. What did Mr. Becker say?

A. To me?

Q. You and Mr. Becker discussing——

A. I think he said he would take it up with Mr. Kelly somewhere or other.

Q. Was the suggestion made during the course of these talks between you and Mr. Sanford Becker that it would be helpful if Mr. Kelly wrote a letter to the securityholders?

A. I have no idea.

Q. You know a letter was written?

A. By Mr. Kelly?

Q. Yes.

A. Yes, sir, I subsequently knew that.

Q. Is it your testimony, Mr. Fribourg, that you did not know that Mr. Kelly proposed or that it was proposed that Mr. Kelly write a letter?

A. Oh, no.

Q. To accompany Mr. Winter's letter?

A. I knew that.

Q. In addition of the fact?

A. I knew that he was—I think I said to Mr. Sanford Becker, "well, listen here. If Mr. Kelly wants to sell at that price, maybe others will" and I think that is how it came about.

Q. Well, then, you having said that, can you recollect any conversation with respect to Mr. Kelly co-operating with you or at least writing a letter to accompany Mr. Winter's letter?

A. I think the only time I saw—the only time I remember is when I saw the letters going out.

Q. Did you discuss with Mr. Kelly the writing of such a letter?

A. Did I discuss that?

Q. Yes, with anybody?

A. Well, I think Mr. Winter said he was going to write a letter or would write a letter.

[fol. 37] Q. Did you know that Mr. Kelly was going to write a letter to accompany Mr. Winter's letter?

A. I think so, yes.

Q. I show you this copy of a letter of Mr. Kelly, addressed to the stockholders of Calton Crescent, Inc., dated May 13, 1944, and ask you if you did not know that that letter was sent out?

A. Oh, yes.

I would have gotten one, anyway.

Q. And if you did not know in advance that it was going to be sent out?

A. I think I knew in advance that it was going to be sent out.

Q. And didn't you see the text of that letter in advance that it was going to be sent out?

A. That I would not be able to say, sir.

Q. Would you say that you did not?

A. Let me read it, please.

Now, I can't—I don't know whether I saw that letter or not. I thought he was going to write a letter, but whether I saw the text of this letter, I don't know whether I did, sir.

Mr. Hanlon: May I first offer that letter in evidence.

Mr. Kahn: No objection.

The Witness: I don't think I saw that letter before I got it.

(The same is received in evidence and marked, "Objectant's Exhibit 15" of this date.)

Mr. Kahn: What is the date of that letter?

Mr. Hanlon: May 13, 1944.

The Witness: This is 1944?

Mr. Hanlon: Yes.

(Colloquy off the record followed.)

Mr. Kahn: All right, you go ahead.

[fol. 38] Q. Do you know whether Mr. Winter's letter, which has been marked as Exhibit 14, was sent out in printed or mimeographed form? I have just shown you a typewritten copy.

A. Yes.

Q. Do you recollect whether the letter that was actually sent out went out in typewritten, printed or mimeographed form?

A. I can't remember.

Q. Do you remember who paid for the preparation of the letter, that is, its transcription in the form in which it was sent out, either printed, mimeographed or typewritten?

A. I am trying to think because I remember Mr. Kelly saying that there wasn't any money there. I don't know, I don't know who did it.

Q. Do you think that possibly the debtor paid for it?

A. I don't know, sir.

Q. You would not say that the debtor did not pay for it?

Mr. Kahn: I object to that—a double negative.

A. I don't know.

The Referee: Objection sustained.

Mr. Kahn: Wait a minute.

Q. Who conducted the conversation with Mr. Winter with respect to the mechanics of carrying this thing out, that is, the mailing of the letters to the securityholders?

A. Who did that?

Q. Yes.

A. Well, I did part of it and I guess he did. I think he did most of it or Mr. Winter may have done it with Mr. Becker.

Q. Mr. Sanford Becker?

A. Yes.

• • • • • • •

[fol. 39] Pages 141-144

By Mr. Hanlon:

Q. Can you tell me by looking at Exhibit 11 how many securities or what securities were purchased through Mr. Winter's offer?

The Referee: Through his office?

Mr. Hanlon: Through his offer.

The Referee: This last offer you are talking about?

Mr. Hanlon: Yes, sir.

A. Do you want that all together in addition?

Q. Can you tell me the names, can you tell me which ones they were?

A. Yes.

Q. You indicate the point and I will read them into the record.

A. This one here.

Q. Indicating?

A. Twamley.

Q. Then you go down with that and tell me where it ends.

A. One, two, three, four, five—Richard Kelly I know about. You mean all that were purchased through that?

Q. Yes, purchased through Winter.

A. One, two—Well, I don't consider that Kelly purchased through Winter because he was acquiring, don't you know, and that was part of it. All right. One, two, three, four, five, six, seven, eight, nine, ten, eleven, twelve.

Q. You have indicated the following. I will give just the names of the purchasers for the record.

A. Do you want me——

Q. No; I will read it (doing so): James F. Twamley; the next, Joseph F. Boshart; Millard Shonyo; St. Lawrence [fol. 40] Co. Trust; the next, Ricketson; the next is Gerson. Any more?

A. Hugo——

Q. (Continuing to read:) Hugo Dresvach; the next is Mrs. Assunta Briani; then Frank D. Richardson; the next Foster——

A. No; those are two houses, stock brokerage houses.

Q. (Continuing:) Henry Nieland and Margaret Mahony; the next Miss Carolyn Louise Pierce; and, finally, Frank J. Sagendorph.

In listing these names, Mr. Fribourg, you have omitted Richard Kelly?

A. Yes. He was a director.

Q. Were his bonds actually deposited with the Corn Exchange Bank?

A. Yes. But we could have bought them directly.

Q. You also omitted the name of Affeld?

A. Yes. But I could have bought them directly.

Q. But they were deposited?

A. It was a convenient way of doing——

Q. Mr. Kelly knew that you were the purchaser of these bonds, did he not?

A. Well, I think he knew it was for Mr. Winter. Whether he knew it was I or not, I don't know.

Q. What is the basis for that?

A. I don't know.

Q. I mean what is the basis of your thinking that he did?

A. Well, I think he surmised that I did.

Q. You really don't know?

A. No, I don't know.

Q. On July 12, 1944 you purchased eight thousand eight hundred of these debentures from William Henry Hays. Was that purchased through Winter?

A. He was a director.

Q. Was that acquired through Winter?

A. Yes, surely.

Mr. Kahn: What do you mean, "through Winter"?

[fol. 41] The Witness: Through the Corn Exchange.

Q. Through the Winter offer?

A. No, no.

(General colloquy followed.)

Q. What is your distinction between the Corn Exchange and the Winter offer?

A. The Winter offer came into the bank because of the Winter offer. But Mr. Kelly, Mr. Affeld and Mr. Hays, I could have bought them direct from him or bought them direct from them, you understand; but for convenience sake he sent the securities to the Corn Exchange Bank and they were paid for through that.

Q. Had you any discussions with Mr. Kelly, Mr. Affeld and Mr. Hays with respect to the purchase of that?

A. No. I think Mr. Becker took care of that.

Q. Mr. Sanford Becker?

A. I think it was Mr. Norman Becker on that.

Q. You had no direct conversation with either of these three gentlemen?

A. No, sir, I did not.

• • • • • • •

Pages 164-166

By Mr. Kahn:

Q. Were you told, Mr. Fribourg, as you now remember, in September, 1943 when Baset advanced an additional sum of $3,615.54 to pay the taxes due to the City of New Rochelle upon this Calton property whether the property was earning enough money to pay operating expenses, interest on the mortgages and taxes?

A. Yes, sir.

Mr. Hanlon: I object to the form of that question.
The Referee: He may answer.

[fol. 42] Q. (Continuing) Were you told that?
A. Yes, sir.
Q. By whom?
A. By Mr. Becker.

The Referee: Which one?
The Witness: Mr. Norman Becker.

Q. Were you also then asked to make a contribution toward the sum of $3,615.54 required to meet the tax payment due to the City of New Rochelle?
A. Yes.

The Referee: Who asked you?
The Witness: I think it was—well, when it came to the money part I think Mr. Norman Becker told me.
~~The Referee: Mr. Norman who?~~
The Witness: Mr. Norman Becker told me that they weren't going to be able to pay their taxes, and I think it was Mr. Sanford Becker who told me the amount and I would have to give them the money.
The Referee: It was Mr. Sanford Becker who asked you to make a contribution?
The Witness: That is right.

Q. Now, in April of 1944, Mr. Fribourg, do you recall any conversations either with Norman or Sanford Becker concerning the advance of an additional amount to pay taxes to the City of New Rochelle?
A. Yes. It was the same thing. I think we had to pay two or three or four times; I don't remember.
Q. Now, do you recall the amount that you were told that had to be paid for taxes in that month of April, 1944?
A. I am trying to think. I don't know whether it was three thousand they had to get together or two thousand. I had to give my share of it.
[fol. 43] Q. Does it refresh your recollection if I told you the amount was $2,305.09?
A. Yes. I told you it was between two and three thousand dollars.
Q. Did you agree to put up your portion of that amount?
A. I did.

The Referee: What was your portion?
The Witness: One-third.
The Referee: And did you put up one-third on the prior me in September?
The Witness: Yes, sir.

*   *   *   *   *   *   *

ages 166-169

By Mr. Kahn:

Q. Coming over to the year 1944, Mr. Fribourg, getting own to the month of April, 1944, do you recall any further scussion at that time with either of the Beckers regarding still further advance by Baset in order to meet a tax payent to New Rochelle?
A. Yes, sir.
Q. Do you recall the amount of that?
A. I think it was around the same amount. I can't reember exactly.
The Referee: Which amount; the same amount as in pril or in the previous September?
The Witness: I think it was around the same as the revious September, around $2,000.
Q. Does it refresh your recollection if I told you the nount advanced in 1944 was $2,000?
A. That is what it was then.
Q. Did you put up your third on that?
A. I did.
Q. Now, at the end of October, 1944 on the basis of our testimony here today there had been advanced by aset in addition to the $15,000 on that mortgage the sum fol. 44] of $7,921.63 for taxes to the City of New Rochelle?
A. Yes, sir.
Q. Are you able to state when that money was repaid?
The Referee: To Baset?
Mr. Kahn: To Baset.
A. When it was? I think it was in 1945, the latter part '45 I think or the beginning of '45. I think it was; can't remember. I would have to look it up. Maybe ou can refresh my memory. It was in 1945 some time.
Q. Now, Mr. Fribourg, does it refresh your recollection I told you that that money was repaid, together with

the $15,000 advance on the mortgage, only when the property was sold in 1946, in January 1946.

The Referee: Not in January, 1946, was it?
Mr. Kahn: Yes, sir.
The Referee: This Calton Crescent property was sold?
Mr. Kahn: In January, 1946.
The Referee: It was the mortgage we sold the other day?
Mr. Kahn: That is right.
The Referee: That is right, excuse me.

A. I don't know. It seems to me as though some of the taxes were paid first. Now, I can't remember offhand; I think the taxes were paid first.
Q. I think you are correct in that, Mr. Fribourg.
A. That is my recollection.
Q. The mortgage was repaid in January, 1946; but the taxes advanced amounted to $7921.63, according to the information which I have here, and was repaid in installments beginning in September, 1944 and running down [fol. 45] through September, 1945.
A. Well, that is better; I think that is the situation, sir.
Q. That is correct.
But do you recall that the first payment that was received by Baset on these advances for taxes of $7921.63 came in September, 1944 when $1,000 was paid back to Baset?
A. I guess that is right.

Mr. Kahn: March, '45.
Mr. Hanlon: Why don't you just read into the record the fact?

(Further colloquy followed.)

The Witness: The only thing is I do remember that we received the taxes before we ever received the mortgage.
Mr. Kahn: The first payment is December, 1944 of $1,000; March '45, $3,000; April, 1945, $500; May, 1945, $500; August, 1945, $1,500; September, 1945, $1,421.63.
The Referee: Well, now, Mr. Hanlon, will you concede that the record did not so show?
Mr. Hanlon: I will concede that Mr. Kahn's statement is received in evidence on that, subject to any verification.
Mr. Kahn: Let us have Mr. Becker testify.
The Referee: Subject to correction.
Mr. Hanlon: Yes, subject to correction.

Mr. Kahn: Mr. Becker is going into this thing in much fuller detail.

The Referee: All right. Go ahead.

Q. Now, do you know, Mr. Fribourg, whether between the time that the Baset mortgage was placed on the property in 1942 and this date in September of 1945 when there was repaid finally the additional advances for taxes [fol. 46] of $7921.63 Baset had received any interest on its second mortgage?

A. No, sir, it did not. Whether it received any interest on its second mortgage.

Q. Yes.

A. No, it did not, sir.

• • • • • • •

Page 178

By Mr. Hanlon:

Q. Now, according to your testimony in response to Mr. Kahn's questions, in September of 1943 you were called upon by the Beckers to contribute one-third of the then due taxes amounting to some $3600. Do you recollect so testifying?

A. That is right.

Q. And your third therefore would have been $1200?

A. That is right.

• • • • • • •

Page 182

By Mr. Hanlon:

Q. Now, it came about, from your testimony by Mr. Kahn, that you were called upon to advance about one-third for further tax payments. Do you remember that?

A. Yes, sir.

Q. And that you did advance one-third of $2300 or something over $700?

A. Yes.

Q. Had you at that time received any payment of the one-third which you had advanced.

A. No, sir.

Q. Wait a minute. (Continuing) Which you had advanced the prior September?

A. No, sir.

Q. Yet you gave this further advance?

A. That is right.

Q. And in October, 1944 you were called upon to ad- [fol. 47] vance one-third or approximately one-third of $2,000?

A. That is right.

* * * * * * *

Pages 184-185

By Mr. Hanlon:

Q. When you talked to Mr. Winter about buying these certificates of Calton you had already advanced the first third of this tax money?

A. That is right.

Q. In the previous September?

A. No part of that had been paid, no.

Q. By May of 1944?

A. Yes, I think that is correct—yes, that is correct.

Q. And in April of 1944 you were called upon to advance the second third of tax moneys?

A. That is correct.

Q. Do you remember discussing that with Mr. Norman Becker or Mr. Sanford Becker in connection with the proposed Winter letter?

A. No, sir.

Q. Those two things had no mutual relation, is that your testimony?

A. That is correct.

Q. You further testified in response to questions of Mr. Kahn that Mr. Winter said he would go along with you in purchasing the bonds. Do you recollect that?

A. That is right.

Q. And as I recollect your testimony, the idea was that he would go fifty-fifty?

A. That was my supposition, my thought at that time, that we would go fifty-fifty.

Q. But he bought no bonds?

A. That is correct.

Q. No securities?

A. That is correct.

Q. Isn't it correct that he also put up no money in the Corn Exchange Bank?

A. That is right.

Q. It was all your money?
A. That is right.
Q. From the beginning?
A. That is right.

* * * * * * *

[fol. 48] EXTRACTS FROM TESTIMONY OF SANFORD BECKER

Pages 206-208

By Mr. Hanlon:

Q. What about Mr. Fribourg, what were the circumstances in connection with his agreeing to come in on the loan?

A. When he heard me make the offer at the meeting about obtaining the loan he said, "You can count me in on it".
Q. Did he specify the amount of his contribution?
A. No, not at that time.
Q. So it was after you had talked to your wife and your mother, that Fribourg had made the comment that you just referred to, that you arrived at the $15,000 figure split three ways; is that correct?
A. No; the fifteen thousand was arrived at the meeting.
Q. Then you determined, I assume you yourself determined, it should be split three ways?
A. It was based upon the fact that he wanted a participation and I had some $10,000 of my wife's and my mother's money.
Q. But I mean you determined on the three-way distribution of the loan, did you not, among them?
A. Yes.
Q. It appears from Mr. Fribourg's testimony that in September of 1943 there was advanced by Mr. Fribourg, your mother and sister——
A. My mother and my wife.
Q. I beg your pardon. (Continuing) Your mother and your wife, each one a third, the sum of $3,616.54?

Mr. Kahn: What is the date of that?
Mr. Hanlon: In September of 1943.

Q. (Continuing) The taxes due the City of New Rochelle. Do you recollect that?
A. That is correct.

Q. Who handled the participations of your wife and mother in that?

A. I did.

[fol. 49] Q. Did you talk to them about it?

A. Yes.

Q. When and where?

A. In my home.

Q. What did you say and what did they say as nearly as you can remember?

A. I told them that they would need some more money for the taxes and they told me, "Have you any money of mine?"; I said, "Yes"; they said, "Go ahead and put it up".

Q. That is the whole conversation?

A. The whole conversation.

Q. Had either of these ladies ever inspected the property after their first advance for the mortgage of the Baset Realty, I mean interiorly inspected it?

A. They were never in the interior of the property.

Q. Have they ever throughout the intervening years acquainted themselves with any of the figures or statements of the company?

A. No, none.

Q. They acted entirely as a result of their conversation with you?

A. The fact that they had a mortgage as security.

Q. I mean, Mr. Becker, they had no other information, except what was derived from you?

A. I don't know what information you mean.

Q. Information as to the business of the building, its financial affairs, its tenancy?

A. None whatsoever.

Q. In April of 1944 there was advanced for taxes due the City of New Rochelle an additional amount of $2,305.09. That appears also from Mr. Fribourg's testimony that you, rather, your wife and your mother each advanced one-third of that. Were the circumstances the same?

A. The same.

Q. Were the circumstances the same in connection with the third advance made in October, 1944 of $2,000?

A. Yes.

[fol. 50] EXTRACTS FROM TESTIMONY OF E. HENRY SONDHEIMER

Page 211

By Mr. Hanlon:

Q. Did you have any familarity with a corporation known as Calton Crescent, Inc., which is the debtor in this proceeding, prior to 1944?

A. No, sir.

Q. When did you first hear of that company?

A. Oh, around the end of '43, the beginning of '44 I would say.

Q. From whom did you first hear of that company?

A. From Mr. Fribourg.

Q. What was it Mr. Fribourg told you about it?

A. He was interested in it.

Q. Interested?

A. In buying bonds of the issue.

Q. Are you quite sure that Mr. Fribourg spoke to you before either of the Beckers?

A. I am almost positive, sir.

Q. Well, what is the first transaction which you had in the securities of Calton Crescent, Inc.?

A. February, 1944 (referring to paper).

* * * * * * *

Page 229

By Mr. Hanlon:

Q. Mr. Sondheimer, you have testified to a group of transactions now with Mr. Fribourg. May I ask you did you have an understanding or open order of some sort from Mr. Fribourg with respect to these purchases?

A. No, sir.

Q. What was the procedure adopted?

A. Well, I know the man had a continuing interest in it, and every time I got an offer I showed it to him and if he wanted it he took it.

Q. As far as you know these were all being purchased [fol. 51] for Mr. Fribourg's account?

A. My confirmation records show that.

Q. That is all you know about it?

A. That is all I know.

Q. Were these purchased for Fribourg's own account?

A. All I know is what my records show.

Q. Did you sell any Calton Crescent bonds to any one else besides Mr. Fribourg?

A. No, sir.

• • • • • • •

Page 232

The Referee: Did you ever have any dealings with a lady named Emily K. Becker?

The Witness: No, sir.

The Referee: Did you ever have any dealings with a lady named Regine Becker?

The Witness: No, sir.

The Referee: I mean did you have either of those ladies as customers of yours?

The Witness: I know what you mean.

The Referee: Did you purchase any securities for them?

The Witness: No, sir.

• • • • • • •

Pages 233-235

By Mr. Hanlon:

Q. You spoke a little while ago of some communication or communications that you sent to securityholders. Have you a copy of that?

A. I have various copies that I sent over the year.

Q. Did you send any circular letter?

A. Yes.

[fol. 52] Q. First of all, do you have a copy of such circular letter or circular letters?

A. I have some copies.

I know on this one letter in '44 the girl just typed up one copy; we did not bother making continued office memorandums.

I have a letter in April, 1946; there is a circular letter which I sent out.

Q. May I have that, please?

Mr. Hanlon: The witness has handed me a letter dated April 8, 1946.

Q. This mimeographed letter, Mr. Sondheimer, just what does that represent; the sheet or letter which you sent from time to time?

A. Yes.

Q. There may have been some slight variations, but similarly——

A. (Interrupting:) Substantially the same.

Q. Do you have another letter of the same date?

A. I have a badly mutilated postal card. I don't know; it was probably back in '44 or '45.

Q. First of all I would ask—You have handed me a postal card. You say you think that was sent out to various holders of Calton Crescent securities in 1944 or '45?

A. I don't know just when it was sent out.

Q. But it was sent out some time prior to April, 1946, which is the date of the letter?

A. Yes.

Q. Have you copies of any letters that were sent?

A. Yes.

Q. Have you any idea what date they were sent out?

A. On the mimeographed letters, from the answers as they were received from time to time.

Q. What would you give me as the approximate date when these mimeographed letters were sent out, of which you show me this as a sample?

[fol. 53] Mr. Kahn: I have not seen those yet.

Mr. Hanlon: I have not offered them.

A. They are in substantially the same form as I have given you there. The exact dates I can't—June, '45, there is a card somebody returned to me.

I can't tell you exactly when I sent them out.

Q. Let me ask you this to simplify it: Would you say from time to time after February 10, 1944 until some time in 1946 you sent out circular letters or cards?

A. Yes.

Q. With respect to——

A. (Interrupting:) Yes.

Q. (Continuing:) Soliciting transactions in Calton Crescent?

A. Yes, sure.

Q. In other words, you were endeavoring to purchase securities of Calton Crescent?

A. I don't remember—yes.

• • • • • • •

Pages 236-237

By Mr. Hanlon:

Q. Did you send any of these circulars to which we have been referring, the letters or the postcards, at the suggestion or request of Mr. Fribourg?

A. No.

Q. How did you get—from whom did you get the names and addresses of the persons to whom these circular letters or postcards were sent?

A. From Mr. Fribourg.

Q. Did he send you that as a list——

A. Yes.

Q. Do you have that list with you?

A. It is on a form here.

(Colloquy off the record followed.)

Mr. Hanlon: Mr. Sondheimer has handed me, your Honor, this list which is in three pieces of paper.

[fol. 54] Q. One question before I offer it in evidence: There are certain markings on this list, lines drawn through names and other notations?

A. Those were all office notations.

Q. Those were put on after you got the list?

A. Yes.

Q. So when you got the list it was barren?

A. Barren of those notations and markings. When we use a list it does get marked up.

Q. Did you get all of these three pieces of paper at the same time?

A. Gee, I would not know.

Q. But you do know that you got them from Mr. Fribourg?

A. Yes.

• • • • • • •

Extracts from Testimony of Sanford Becker

Pages 249-250

By Mr. Hanlon:

Q. Did you consult with your mother or your wife, as the case may be, with respect to these Sondheimer purchases?

A. Oh, yes.

Q. From time to time?
A. Yes.
Q. Each time?
A. Not each time.
Q. When did you have your first discussion, having reference to the purchases which are indicated on Exhibits 12 and 13?
A. I could not fix the date.
Q. Approximately when, Mr. Becker?
A. I couldn't fix the date. I see my wife every day and I see my mother most every day.
Q. Would it be fair, summing up your testimony, to say from time to time you saw them—from time to time when you saw them you mentioned these Calton Crescent securities?
A. Yes.
[fol. 55] Q. Did you give them any accounting of what you were buying?
A. No. They never asked for any account.
Q. You bought and charged them for their accounts?
A. Yes.

• • • • • • •

Extracts from Testimony of Myles B. Amend

Pages 259-260

By Mr. Hanlon:

Q. Did Mr. Norman Becker or Mr. Sanford Becker make any statement to the stockholders at a meeting——

The Referee: Which stockholders?

Q. (Continuing:) The stockholders of the debtor, Calton Crescent, Inc., at the meeting of February 17, 1942, at which meeting there was discussion with respect to the identity of the persons who were advancing the money to Baset Realty Corporation to make the loan?
A. I don't think they did.
Q. Have you any recollection that they did?
A. No, I haven't.

• • • • • • •

Pages 260-263

By Mr. Hanlon:

Q. Mr. Amend, the statement was made by Mr. Sanford Becker in his testimony——

The Referee: Which page is that?
Mr. Hanlon: Page 67 of the minutes.

Q. (Continuing:) And I read you with respect to this subject matter and ask you this question:

> [fol. 56] "Q. I ask you this, Mr. Becker: Is there any written communication from you to the debtor or to the officers of the debtor in which you stated the names of the persons who were actually advancing this money, that is, your wife, your mother and Mr. Fribourg?
> "A. I don't know if there is anything in writing; but all of the directors——"
> "Q. I only asked you that one question: Was there anything in writing?
> "A. I don't know. There should be."
> "Q. I quite agree. Do you know of any communication to the stockholders of like tenor giving them that information?
> "A. I stated it at the meeting.
> "Q. At which meeting; the meeting of the stockholders?
> "A. A meeting of the stockholders."

and then skip a question (continuing to read)

> "Q. Mr. Becker, I assume you are referring to the minutes of the stockholders' meeting, the annual meeting held on February 17, 1942, and I am directing your attention to one of the later pages to help you. Will you look through those and show me where you informed the meeting of the identity of the persons who were putting up the money?"

and in answer to that question the minutes show that Mr. Becker indicated the following paragraph from those minutes:

"'Mr. Amend stated that he had conferred with Mr. Eisenberg (that is at the top of page 69 of the minutes) and that Mr. Becker would be willing to loan $15,000 on second mortgage provided he be given the right to [fol. 57] designate a majority of the board of directors and the right to appoint the managing agent, and Mr. Becker stated that he would increase the offer of the mortgage loan in his letter to $15,000 accordingly."

"Q. Is that the statement you indicated?"

and the answer was "Yes"; and then I went on (continuing to read):

"I ask you where in the minutes it is shown?

"A. That is in reference to that conversation. The minutes refer to a conversation I had with Mr. Amend and Mr. Eisenberg in which conversation I told them who the parties were that were participating in the loan."

Now I ask you, Mr. Amend, to state whether in words or substance Mr. Sanford Becker made any statement to you with respect to the persons who were participating in the loan?

A. No. I don't think he did.

Q. You have no recollection of such a statement?

A. No, none whatever.

The Referee: Would you swear he didn't?

The Witness: No. It is five years ago, your Honor. But my best recollection is that he did not.

Q. I show you now, Mr. Amend——

Interrupting myself: Did any one else to the best of your recollection make any statement to you at or about this time, that is, February, March or April, 1942, with respect to the identity of the person or persons who were advancing the money to Baset Realty Corporation to make this loan?

A. Not to the best of my recollection, no.

* * * * * * *

[fol. 58] EXTRACTS FROM TESTIMONY OF CHARLES G. WINTER

Pages 315-318

By Mr. Hanlon:

Q. Did you have any familiarity with an apartment house in New Rochelle known as Calton Crescent?
A. I had nothing to do with it.

The Referee: What?
The Witness: Nothing.
Mr. Hanlon: Will you please keep your voice up.

Q. Had you ever seen that apartment house?
A. Never.
Q. Do you know anything about its affairs at all?
A. No, nothing.

The Referee: What is the name of the apartment house?
Mr. Hanlon: Calton Apartments.

Q. Mr. Winter, I show you what purports to be a copy of a letter signed "Charles G. Winter", addressed to Calton Crescent, Inc., dated May 2, 1944, being Objectant's Exhibit No. 14 in this proceeding; and ask you if you remember that letter or the letter of which that is a copy?
A. I don't remember the letter.
Q. Do you remember having any conversation with Mr. Fribourg with respect to sending a letter of this type?
A. No.
Q. Did you have any conversations with Mr. Fribourg with respect to making an offer for purchasing securities?
A. No.
Q. Of Calton Crescent, Inc.?
A. No.
Q. Did you have a bank account at the Corn Exchange Bank, Grand Central branch, at any time in your name?
A. Yes.
Q. Do you still have that account?
A. No.
[fol. 59] Q. How long did that account exist?
A. Very shortly.
Q. Whose money was in that account?
A. Mr. Norman Becker took me to the bank and introduced me to some manager or whoever it was, and he put the money in the bank.

Q. "He" being who?
A. Mr. Norman Becker put the money in the bank.
Q. No part of that money was yours?
A. No.
Q. You were about to say something else. What was it?
A. And that is how the account was opened I wanted to say.
Q. Did you ever make any deposits in that account yourself?
A. No, sir.
Q. Did you ever make any withdrawals from that account?
A. Only the checks that were made out that I signed.
Q. What checks were those?
A. Whatever they made out for the bondholders or whatever it was; I don't know what it was.

(General colloquy ensued.)

Q. What was the purpose of this bank account so far as you knew?
A. Well, as I remember it, I mean Norman Becker came to me and talked to me about opening an account. It was like an accommodation, that is the way he put it to me; so I just went with him to open the account.
Q. Did you have any conversation with Mr. Norman Becker as to what he was going to use the account for?
A. That they were buying some bonds or something like that. I found out later that they were buying bonds and stuff like that.

• • • • • • •

[fol. 60] Page 318

By Mr. Hanlon:

Q. You say you drew checks on that account?
A. Yes.
Q. Or, rather, signed checks?
A. Yes.
Q. Do you have those canceled checks?
A. I gave them to Norman Becker.
Q. When did you give them to him?
A. When I got them from the bank.

Q. Do you have any bank statements covering the account?

A. When I got them, when I got the bank statements, I gave them to Norman Becker.

Q. So that you have no bank records with respect to this account at all?

A. Nothing at all.

* * * * * * *

EXTRACTS FROM TESTIMONY OF MR. NORMAN S. BECKER

Pages 346-350

By Mr. Hanlon:

Q. After the Baset Realty loan was made you became a director and officer of the debtor. Did you continue to interest yourself in finding prospective purchasers for the property? I am referring, of course, to the apartment house.

A. At that time, yes.

Q. Did you receive any offers or inquiries from others with respect to the purchase of the property?

A. I received inquiries asking for figures about the building, but no offers.

Q. Would you be able to estimate the frequency with which those inquiries were received?

A. Well, different brokers would call up and ask for different figures.

Q. What sort of figures?

A. They would want to know what the operating charges [fol. 61] were, what the rents were, what the mortgages were, and what was due on conditional bills of sale, and the amount of taxes.

Q. How frequently were those inquiries received, if you can estimate?

A. It is hard to estimate.

Q. With a fair degree of frequency?

A. I would say ever so often and then a broker would hear about it from somebody else and ask for the figures.

Q. He contacted you?

A. He contacted me or Mr. Kelly, or Mr. Kelly asked him to contact me.

Q. These inquiries in one fashion or another were handled by you?

A. Mr. Kelly in most of the times referred them to me.

Q. So that ultimately you handled them?

A. Ultimately I had to give them the figures.

Q. Now, did you get any offers after April, 1942 as distinguished from inquiries?

A. No.

Q. No offers whatever?

A. Not then, no.

Q. From that time on project yourself right to the time that the property was sold. Will you tell me what offers, if any, were received?

A. I think the first semblance of an offer was from a fellow by the name of Rubin.

Q. Do you remember how much that offer was?

A. It purported to be about $250,000, if I remember.

Q. Tell me why are you putting it that way, saying "it purported to be"?

A. From the type of broker who made the offer. I personally had no confidence in it whatsoever.

Q. Was that offer made on account of—at least purportedly on account of—one Solomon Solomon?

A. I think the name sounds familiar, because I tried to check him up to find out who he was and could not get any information from anybody.

[fol. 62] Q. This Rubin was a broker?

A. He was a broker.

Q. And he purported to bring in an offer of $250,000?

A. Yes. I never met the man though.

Q. When was it that the purported offer was made?

A. I can't tell you offhand.

Q. You recollect that Rubin brought a suit, don't you?

A. Yes, yes.

Q. He claimed in that suit to have brought about this offer in November, 1944. Would you say that is correct?

A. If he says so, I suppose it is. I mean I would not have any independent recollection of just when it was.

Q. Do you know anything about an offer by one Tannenbaum for the purchase of this property?

A. Who was he; a broker, a principal, or what? I don't know him at all.

Q. Do you recall any offer in the neighborhood of $280,000 in 1945?

A. I don't know anybody by the name of Tannenbaum at all. I know a real estate broker by the name of Jerome Tannenbaum; he handles loft buildings.

Q. Forget the name of Tannenbaum; the name may be in error.

Do you recall an offer for this property in the sum of $280,000 in 1945.

A. In the fall of 1945 I think there was somebody that made an offer of that price, a broker.

Q. Two hundred and eighty thousand?

A. About, yes.

Q. Do you remember on whose behalf that offer was made?

A. No, I don't.

Q. The principal was not disclosed?

A. No. It was something in the nature of an inquiry.

Q. What was done about that on the part of the debtor?

A. Well, at that time—I think my recollection would be that they decided that they should, in view of the market, try to get $300,000 for the property.

[fol. 63] Q. Was that the inquiry or offer or whatever it have been, for $280,000?

A. It was an inquiry; it never crystalized into an offer.

Q. But it was turned down, in any event?

A. The inquiry was turned down. It was made in the form of an inquiry, "Would you take $280,000?"

Q. And the debtor answered No in substance?

A. Yes. I think I was the party that said the stockholders would have to vote on any proposition that would have to be made so I would not be in a position to tell him any price; it would be a question of submitting a firm offer with a deposit and then submitting it to the stockholders.

Q. Did you say anything to the broker in question about getting a minimum offer of $300,000?

A. I told him that I thought $300,000 should be the price, yes.

* * * * * * *

Pages 352-355

By Mr. Hanlon:

Q. Do you know Mr. Charles G. Winter who was on the stand this afternoon don't you?

A. Yes.

Q. How long have you known Mr. Winter?

A. Oh, I imagine about four or five years.

Q. I show you this letter, a copy of a letter which I showed Mr. Winter——

The Referee: Which one is that?
Mr. Hanlon: Objectant's Exhibit 14, your Honor, being the letter signed by Winter, addressed to the debtor.

Q. (Continuing) I ask you if you are familiar with that? I am not referring to that particular copy; I am referring to the letter.

[fol. 64] Mr. Kahn: Is that the one with the offer?
Mr. Hanlon: Yes.

A. Yes.
Q. When did you have any information with respect to such an offer?
A. When I saw the draft of the letter which Mr. Kelly prepared.

The Referee: That letter?
The Witness: Of this letter. Mr. Kelly prepared that letter.
Mr. Hanlon: That is referring, your Honor, to this letter from Winter to the debtor.
The Referee: Yes, Exhibit 14.

Q. When was it that you first saw the draft of the letter? It is dated May 2, 1944, if that will help you.
A. Oh, I imagine it was about a week before that.
Q. Did you have any conversation with Mr. Kelly?
A. Oh, yes.
Q Where was this conversation?
A. In Mr. Kelly's office.
Q. Where was his office?
A. 233 Broadway, in the Woolworth Building.
Q. You came down at Mr. Kelly's request?
A. Oh, yes.
Q. Did you know at that time what you were coming down for?
A. I used to come down to his office regularly.
Q. So on this particular occasion he called you down?
A. He called me down there.
Q. And he showed you what turned out to be this particular letter, Objectant's Exhibit 14?
A. Yes.

Q. What conversation did you have with Mr. Kelly with respect to this?

A. Mr. Kelly said he prepared a letter of an offer which was to go out and he wanted to prepare an accompanying letter with it because he felt that the time to get out of [fol. 65] Calton as far as he was concerned was the present time, and that he was not interested in selling his stock unless all of the stockholders were offered the same proposition that was being submitted by this letter here; and he said that he personally would be very happy if every stockholder would do it and would get out and would be able to wind up the whole Calton thing and make a finish of it.

Q. Let me ask you this before you go any further with the conversation: Had you heard anything about a proposal to buy the debentures and stock at three per cent of the par value of the bonds?

A. Yes.

Q. Prior to the time that you went down to Mr. Kelly's office?

A. He spoke to me about it when he was up at the annual meeting.

• • • • • • •

Page 356

By Mr. Hanlon:

Q. Did you have more than one conversation then with Mr. Kelly with respect to the subject matter of selling or making an offer to the securityholders between those two dates?

A. I may have. I would not have any independent recollection now of whether I did or not; I mean I used to see him so often it is just possible when I did see him it was discussed.

Q. During this intervening period did you have any discussion with Mr. Fribourg on this same subject.

A. I think so—I think so. As a matter of fact, I think Mr. Kelly had some discussion at the annual meeting with Mr. Fribourg. It was at one of the meetings.

Q. Did you hear the discussion?

A. Yes, naturally. I was there.

• • • • • • •

[fol. 66] Page 358

By Mr. Hanlon:

Q. Did you have any conversation with Mr. Winter?

A. Did I?

Q. Yes.

A. Yes. I used to go to lunch with him once in a while. Of course I had conversations with him.

Q. My question was directed to the subject matter of these securities. Did you have any discussions with him?

A. In a very limited way. Most of Mr. Winter's instructions are done only through one person and that is Mr. Eisenberg.

Mr. Hanlon: I move to strike that out.

The Referee: Strike it out.

Did you have any discussion with Mr. Winter with respect to this matter?

The Witness: Very limited.

The Referee: What did he say?

The Witness: Winter said he was going to make an offer for some of the securities of the Calton and that he was going to work it out with Walter.

The Referee: Walter who?

The Witness: Walter Fribourg; and he just wanted to let me know about it, that is all.

• • • • • • •

Pages 359-362

By Mr. Hanlon:

Q. Do you know whose money it was?

A. It was Fribourg's bank, so I imagine it was from Fribourg.

Q. Were you told by Fribourg whether or not he put any money in that account?

A. In an offhand way I was given to understand that it was.

[fol. 67] Q. That it was Fribourg's money?

A. Yes.

Q. Now, did you receive from Mr. Winter at any time canceled checks on that account?

A. I might have received one or two months from him and to give to Mr. Fribourg, that he came in to go to lunch

with Fribourg and Fribourg was not there, and he might have handed me a statement as he handed me lots of times papers and say, "Give these to Walter".

Q. Would you say that he did in that case hand you the canceled checks?

A. Maybe he did.

Q. You would not be in a position to say that he did not do so; he may or may not have?

A. He may or may not have.

Q. We were talking a while back about a conversation with Mr. Kelly at his office at 233 Broadway on the day he showed you the draft of the Winter letter, Objectant's Exhibit 14. Will you go on with that conversation? You started to tell me what happened and I interrupted you to go back——

A. Well, I mean I can tell you what the gist of it is.

Q. That is all I want.

A. As I remember, the gist of the conversation was he thought it was a good idea to make the offer as he wanted all of the securityholders to have it. He did not want to sell unless the same offer was made to every security-holder; he even went farther and said, "If Winter wants to buy, we have no money. Winter will have to pay to have these letters mimeographed and sent out". But I thought it would be perfectly proper that we send the letters out for him.

The Referee: Who is this; Kelly?

The Witness: Yes.

[fol. 68] Q. Then Kelly showed you this draft letter?

A. Yes.

Q. You will notice it begins with a statement—it being signed by Charles G. Winter——. "I will purchase the six per cent bonds of Calton Crescent, Inc." and so on?

A. Yes.

Q. I particularly direct your attention to the pronouns "I will purchase".

A. Yes.

Q. Did you in connection with that conversation with Mr. Kelly say that Mr. Winter is not the buyer?

A. I don't recall that.

Q. Did you have any conversation with Mr. Kelly which would indicate that Winter was not the buyer?

A. I knew Winter was mixed up with Fribourg; that I did know.

Q. Didn't you know at this time that Fribourg was the one that was doing the buying?

A. I did not have any definite knowledge. I knew they were brother-in-laws and very friendly and both mixed up with Eisenberg; I knew if one made the offer the other must be interested in it. I know that I assumed that at some time Fribourg was interested in the offer.

Q. All you knew was that Winter was the name that was being used?

A. That is right.

Q. And when you were down there to talk to Mr. Kelly at that time did he also show you the draft of the letter which he proposed to send out to the stockholders over his name, being Objectant's Exhibit 15?

A. I believe he did. I would not have any independent knowledge right now. I believe he did, although it is some days later I notice on the date.

• • • • • • •

[fol. 69] Page 363

By Mr. Hanlon:

Q. Mr. Sondheimer testified that he sent out circular communications on several occasions to securityholders of the debtor, and in response to my request he handed me these three pieces of paper as the list of names which he had for that purpose. I am referring to Objectant's Exhibit 23. Did you ever see that list or those lists?

A. Yes, sure.

Q. Did you prepare those?

A. No.

Q. Do you know by whom they were prepared?

A. By the high quality of the typing on here it looks like Fribourg.

Q. Can you identify those as having been prepared in your office; I mean the suite at 11 West 42nd Street?

A. No, there is no way of identifying this group. I know I did not prepare it. I saw this on Fribourg's desk, but I did not prepare this.

Q. I did not hear you.

A. I saw this on Fribourg's desk, but I did not prepare this.

• • • • • • •

Pages 419-420.

By Mr. Kahn:

Q. Now apparently, Mr. Becker, according to this Exhibit No. 17, the lowest amount of indebtedness that the debtor corporation ever ended up with in any one of the months for 1944 or '45 was in the month of November, 1945 when the outstanding indebtedness stood at $12,-892.85?

A. Whatever the chart shows. The figures are correct.

[fol. 70] Q. Yes?

A. I don't remember. I mean whatever is down there is taken from the records.

* * * * * * *

Pages 424-425

By Mr. Kahn:

Q. Mr. Becker, did Baset ever collect a dollar of interest on any of these advances that were made for taxes?

A. It wanted to, but it never did; it never got a penny interest on any advance made and some were as much as two years, they never got a penny interest on any advances made.

Q. Not even at the final closing?

A. Not even at the final closing.

Q. Mr. Becker, was Calton Crescent ever——

The Referee: How did you satisfy this Baset mortgage without paying up the interest?

The Witness: The interest was paid up at the time it was satisfied.

The Referee: I thought you said there was never any interest——(interrupted by)

The Witness: Interest on advances.

Mr. Kahn: I think you misunderstood me. This was not on the mortgage indebtedness.

The Referee: They did not get interest on the amount of taxes that were paid?

Mr. Kahn: Never, not a penny.

The Referee: At no time?

Mr. Kahn: Never (further discussion following).

Q. Am I correct, Mr. Becker, in my reading of this schedule that you handed me that Baset received no in-

[fol. 71] terest on the mortgage? You have already told us that it received no interest on the tax advances, but it received no interest on the mortgage until January, 1946.

A. That is right, yes, sir.

• • • • • • •

Page 426

By Mr. Kahn:

Q. Mr. Becker, I show you an original letter addressed to Sanford Becker by Mr. Kelly on the stationery of Calton Crescent, Inc., dated May 22, 1944, and ask you if that is an original letter that came from the files of the debtor and whether you recognize Mr. Kelly's signature?

A. Yes, it is.

Q. Will you look at the lead pencil letter attached to that and tell me whose handwriting that is in?

A. That is Mr. Kelly.

Q. His personal handwriting?

A. Yes.

Q. Is that the draft of the letter that Mr. Kelly got up for Mr. Winter to send out?

A. Yes, it is.

Mr. Hanlon: When you speak of the Winter letter you are talking about——(interrupted by)

Mr. Kahn: There is only one Winter letter.

Mr. Hanlon: I know, Exhibit 14, Objectant's Exhibit 14.

Mr. Kahn: Yes.

Pages 428-429

By Mr. Hanlon:

Q. Now, Objectant's Exhibit 30 is as I have just stated: the report to stockholders, including income statement and balance sheet for the year ended December 31, 1942.

[fol. 72] Do you have similar sheets for the years thereafter ending December 31, 1943, '4 and '5?

A. No, I have not.

Q. Is this the last balance sheet?

A. This is the last balance sheet because we had no money to give to an auditor making it up.

Mr. Hanlon: When I speak of "this", your Honor, I mean the balance sheet as of December 31, 1942.

The Referee: Yes.

Q. Perhaps we can cover it in this manner, Mr. Becker: This balance sheet for 1942 shows a capital deficit of $23,026.31?

A. Yes.

Q. In other words, the liabilities are greater than the amount of assets; is that correct?

A. That is what it looks like.

Q. Would you say that a balance sheet prepared for any one of the following years, that is 1943, '44, '45, would have shown any improvement in that situation?

A. No. I would rather say it would have showed up much worse.

Q. You were quite familiar with the affairs of the debtor and it is your opinion that the capital stock deficit would have been larger?

A. I imagine so.

(There ensued further informal discussion.)

Mr. Hanlon: Would this suffice for your purpose, in view of the testimony here concerning the additional losses after 1942: that it would appear to be obvious that to the extent of these additional losses they would be reflected in any balance sheet by increasing the capital stock deficit?

Mr. Kahn: We will assume for this proceeding that to be the fact.

[fol. 73]

Exhibits

Objector's Exhibit 7

Copy

11 West 42nd Street,
February 17, 1942.

Calton Cresent, Inc., 420 Lexington Ave., New York City.

Dear Sirs:

Providing the necessary legal stockholders approval is obtained a client of mine has offered to loan to Calton

Crescent, Inc., a sum necessary to clear up all the defaults in taxes interest and amortization now due on the first mortgage held by the Poughkeepsie Savings Bank. Said sum to be secured by a bond and mortgage on all the property and assets of the corporation, subject to the reduced first mortgage now on the premises.

The offer is made on the following conditions:

1. Acceptance with 30 days.

2. Term three years from date of closing.

3. Interest at the rate of 4½% payable quarterly.

4. Form of bond and mortgage, the usual corporate resolutions, stockholders' consent and certificate of consent shall be in the forms for second mortgages subject to approval of Title Guarantee and Trust Company and counsel for lender.

5. Calton Crescent Inc. to pay all costs such as, examination of title, title insurance, survey, mortgage tax, revenue stamps recording fees and attorneys' fees.

[fol. 74] 6. That the corporation secure written consent of the Poughkeepsie Savings Bank to withhold foreclosure for a reasonable time so that the loan can be closed and defaults made good.

7. That the proposed lender name a licensed real estate broker as managing agent at an expense to the corporation of not more than 3% and that no change can be made without the written consent of the lender.

8. That any and all stockholders be permitted to participate in this loan if they so desire.

Yours very truly, (Signed) Sanford Becker.

[fol. 75]

Objector's Exhibit 11

Walter A. Fribourg Account

11/ 8/41	$2,000.00	Goldwater & Co.	$230.00
3/28/42	3,000.00	Goldwater & Co.	250.00
7/31/42	5,000.00	Reiley & Co.	237.50
8/ 5/42	2,000.00	Reiley & Co.	95.00
5/12/43	1,500.00	Shaskan & Co.	105.00
5/22/44	2,000.00	James F. Twamley	60.00
5/25/44	1,000.00	Josephine F. Boshart	30.00
5/25/44	500.00	Millar D. Shonyo	15.00
5/25/44	2,000.00	St. Lawrence Co. Trust	60.00
5/25/44	1,500.00	Ricketson	45.00
5/25/44	8,250.00	Richard Kelly	247.50
6/ 6/44	4,000.00	Affeld	120.00
6/21/44	4,000.00	Gerson	120.00
6/ 1/44	250.00	Hugo Dresvach	7.50
6/22/44	500.00	Mrs. Assunta Riani	15.00
6/20/44	250.00	Frank D. Richardson	7.50
8/16/44	500.00	Foster & Adams	15.00
8/29/44	500.00	Kissel Kinticutt & Co.	15.00
6/22/44	2,250.00	Henry Nieland & Margaret M. Mahony	67.50
6/30/44	500.00	Miss Caroline Louise Pierce	15.00
7/12/44	8,500.00	William Henry Hays	318.75
8/16/44	1,000.00	Frank J. Sagendorph	30.00
4/16/45	500.00	Sondheimer & Co.	35.00
6/13/45	1,000.00	Sondheimer & Co.	107.50
6/22/45	500.00	Sondheimer & Co.	55.00
10/30/45	500.00	Sondheimer & Co.	55.00
1/29/46	500.00	Sondheimer & Co.	55.00
4/ 3/46	500.00	Sondheimer & Co.	60.00
6/ 4/46	500.00	Sondheimer & Co.	131.05

[fol. 76]

Objector's Exhibit 12

Regine Becker Account

2/10/44	$2,500.00	E. Henry Sondheimer Co.	$168.75
2/21/44	5,000.00	E. Henry Sondheimer Co.	337.50
4/17/44	3,500.00	E. Henry Sondheimer Co.	240.63
4/26/44	4,500.00	E. Henry Sondheimer Co.	258.75
4/20/44	15,000.00	E. Henry Sondheimer Co.	1,068.75
4/25/44	2,500.00	E. Henry Sondheimer Co.	143.75
4/24/44	5,000.00	E. Henry Sondheimer Co.	275.00
5/ 9/44	3,000.00	E. Henry Sondheimer Co.	150.00
5/ 5/44	1,000.00	E. Henry Sondheimer Co.	55.00
8/30/45	2,500.00	E. Henry Sondheimer Co.	362.50
	$44,500.00		

Objector's Exhibit 13

Emily K. Becker Account

5/24/44	$2,500.00	Sondheimer & Co.	$137.50
6/ 8/44	2,500.00	Sondheimer & Co.	100.00
11/14/44	250.00	Sondheimer & Co.	10.00
6/21/45	2,500.00	Sondheimer & Co.	262.50
11/16/44	37,500.00	Reynolds Richards & McCutcheon	3,750.00
2/ 5/45	7,550.00	Clay—YWCA	750.00
	$52,800.00		

[fol. 77] OBJECTOR'S EXHIBIT 14

50 Park Avenue,
May 2, 1944.

Calton Crescent, Inc., 11 West 42nd Street, New York 18, N. Y.

GENTLEMEN:

I will purchase the 6% debenture bonds of Calton Crescent, Inc. together with the corresponding shares of its capital stock, in units of one share of stock with each $50--of bonds, for a unit price of 3% of the par value of the bonds. This offer is subject to termination without notice.

Bonds and stock certificates must each be accompanied by separate instruments of transfer duly executed in blank with the signature guaranteed by a bank or trust company having an office or correspondent in New York City or by a brokerage firm having membership in the New York Stock Exchange or clearing house of the New York Curb Exchange. If such instruments of transfer are executed by a corporation, or by an administrator, executor, trustee, guardian, attorney or other fiduciary, proper evidence of authority must be furnished.

If payment is to be made to a party other than the registered owner of the securities presented, proper instruments of assignment from such registered owner to the party to whom payment is to be made must be presented, accompanied by all documents necessary to effectuate such assignment, and payment of all transfer taxes upon such assignment.

The Corn Exchange Bank Trust Company, Grand Central Branch, 1 East 42nd Street, New York City, will honor sight [fol. 78] draft drawn on me when accompanied by proper documents, with the necessary bond and stock transfer tax stamps attached. If no tax stamps are attached please instruct Corn Exchange Bank Trust Company to allow deduction for necessary stamps at the rate of 21¢ on each $100—bond.

Yours very truly, (Signed) Charles G. Winter.

OBJECTOR'S EXHIBIT 15

Calton Crescent, Inc.

11 West 42nd Street

New York 17, N. Y.

Richard Kelly, President, 233 Broadway.
Wm. Henry Hays, Vice President, 71 Broadway.
Sanford Becker, Treasurer.
Norman S. Becker, Secretary.

May 13th, 1944.

To the Stockholders of Calton Crescent, Inc.:

An offer of Mr. Charles Winter, copy of which is enclosed herewith, is submitted for your careful consideration and prompt action if acceptable.

The report of our treasurer, filed with the Manufacturers Trust Company as trustee of the indenture under which our debentures are issued, shows receipts during 1943 of $57,169.52, and disbursements during 1943 of $63,586.77. This report may be examined at the office of the trustee, 55 Broad Street, New York City, or a copy thereof may [fol. 79] be examined at our office. These figures include the receipts and disbursements of Baset Realty Corp. as second mortgagee in possession since September 30, 1943. For the first four months of 1944 the receipts of the mortgagee in possession are reported to us as $19,890.50 and its disbursements $20,962.23. The disbursements include payment of $3,500 on account of the principal of the first mortgage in 1943 and $875 in 1944, and payment on account of refrigerators and other rehabilitation.

We have never, in any year, earned enough to pay both for necessary repairs and rehabilitation and the amortization due on the first mortgage, and we have, of course, never been able to set aside any funds as a reserve for depreciation. I expect to accept Mr. Winter's offer, as to the securities I own.

(Signed) Richard Kelly, President.

[fol. 80] OBJECTOR'S EXHIBIT 20

Ledger Sheets of E. Henry Sondheimer & Co.

Account of Walter Fribourg

(See Opposite)☞

(Here follow 2 Photolithographs, side folios 81, 81a)

7

Objector's Exhibit 20

Walter H. Furlong 304 Carlisle Ave. Vallhau, N.Y.

Obj's Ex. 20

Date		Bot	Sold	Price	Comm	Tax	Int	Dr	Cr	Bal Dr	Bal Cr
Feb 10	Callton Crescent 6% /53 w.i.	2000		6 1/4	12 50			164 75		164 75	
14	Check Rec								164 75		
	Callton Crescent 2 1/2 M Del								None		
21	Callton Crescent	5 M		6 1/4	25 –			337 50		337 50	
26	Check Rec								337 50		
April 17	Callton Crescent	3100		6 1/8	12 50			240 63	~~240 63~~	240 63	
19	Callton Crescent	Delf							240 63		
20	Callton Crescent 6/53	15 M		6 7/8	15			1068 75			
20	Callton Crescent 6/53	5 M		5	25			275 –			
	Acc of Rec / Check Rec								1068 75 / 275	275 –	
25	Callton Crescent 6/53	3000		5 1/4	12 50			193 75		193 75	
30	Check Rec								193 75		
26	Callton Crescent 6/53	4500		5 1/4	22 50			258 75		258 75	
30	Check Rec								258 75		
20	Callton Crescent 15 Del								Rec		
	Callton Crescent 5 M Del								Rec		
27	Callton Crescent 5 M Del								Rec		
Aug 3	Callton Crescent	3 M		4 1/2	15			150		150 –	
3	Callton Crescent	1 M		5	5			55 –		205 –	
	Check Rec								55	150	
	Callton 1 M Del								Rec		
16	Check Rec								150 –		
27	Callton Crescent	2 1/2 M		5	12 50			137 50		137 50	
31	Check Rec [illegible]								137 50		
27	Callton 2 1/2 M Del								Rec		
June 8	Callton Crescent 6/53	2 1/2 M		3 1/2	12 50			100 –		100	
12	Check Rec								100		
	Callton 2 1/2 M Del								Rec		
13	Callton 2 1/2 M Del								Rec		
Nov 14	Callton Crescent 6/53 (Stk)	250 –		3	2 50			10 00		10	
20	Check Rec								10 –		

Walter Fribourg 304 Colina Ave Patterson, N.Y.

Date		Bu	Lbs	Price	Premium	Total	Frt	Dr	Cr	Bal Dr	Bal Cr
Feb 15	Cotton Crescent			6	5 –			30 –		30 –	
18	Check Rec								30 –		–
22	Cotton Crescent								Rec		
Mar 5	Studebaker Talk No. 797	6280 –		18				37710.5	37710.5	3771.05	
6	Check Rec								37710.5		
	Studebaker								Rec		
June 15	Cotton Crescent	1 M		10	7.50			107.50		107.50	
18	Check Rec								107.50		
	Cotton Crescent									Rec	
20	Cotton Crescent			10	12.50			262.50		262.50	
22	Cotton Crescent	500		10	5 –			55 –		317.50	
25	Check Rec								262.50		
	do								55		
	Cotton Crescent								Rec		
26	Cotton Crescent								Rec		
Aug 30	Cotton Crescent	2500		14	2.50			302.50		302.50	
Sept 4	Cotton Crescent										
15	Check Rec								302.50		
Oct 30	Cotton Crescent	8500 –		10				55 –		55	
	Cotton Crescent 8500 Rec										
	Cotton Crescent										
	Cotton Crescent										
	Check Rec										
	Cotton Crescent	250		11	5 –						
	Check Rec										
	Cotton Crescent										

[fol. 82] OBJECTOR'S EXHIBIT 21

E. Henry Sondheimer Co.

Investment Securities

331 Madison Avenue

New York 17, N. Y.

Murray Hill 2-3055,
TWX NY1—1215,
April 8, 1946.

DEAR:

We have an order to buy Calton Crescent 6% bonds with stock.

You are the registered holder of $ bonds and shares of stock, according to our records, and we can pay you $ for your holdings, less Federal and New York State transfer tax stamps.

As this order is for a limited quantity, will you please reply as soon as possible.

Very truly yours, E. Henry Sondheimer Co.

EHS:SS.

[fol. 83] OBJECTOR'S EXHIBIT 22

Postal Card

E. Henry Sondheimer Co.

Investment Securities

331 Madison Avenue

New York 17, N. Y.

Murray Hill 2-3055

We understand that you are the holder of $ Calton Crescent Income Debenture 6% Due 1953 with share of stock. We are in a position to purchase your holdings for $. If this is of interest to you, please communicate with us for confirmation.

Very truly yours, E. Henry Sondheimer Co.

[fol. 84] RESPONDENTS' EXHIBIT 17

Chart prepared by Mr. Norman Becker showing rents collected and expenses and other charges of Calton Crescent, Inc., on a monthly basis for the years 1944 and 1945.

(See Opposite) ☞

(Here follows 1 Photolithograph, side folio 85)

1944	Monthly Rent Collected	Tax arrears paid by Basset	Circuit Operating Bills Payable	Interest Due Basset	Conditional Bills & sale Refrigerations	Old Account Payable	Insurance Loan Payable to Bank
Jan	467550	361654	1019239	750.	198899	177711	241264
Feb	505550	361654	1035844	750.	192974	177711	233349
March	526050	361654	1088299	750.	187049	177711	225434
April	4999 -	592163	950154	93750	181124	177711	217519
May	4757 -	592163	846404	93750	175199	177711	209604
June	5168	592163	1058779	93750	169274	177711	201689
July	~~5418.~~ -	592163	1158020	1125.-	163349	177711	144477
Aug	4693	592163	937679	1125.-	157424	177711	136562
Sept	4973 -	592163	1002052	1125.-	151499	177711	128647
Oct	5005 -	792163	1025546	131250	145574	177711	120732
Nov	5242.-	792163	1073796	131250	139649	177711	112817
Dec	5368	692163	955241	131250	133724	177711	104902
1945 Jan	5213.-	692163	1041679	1500.-	122799	177711	96987
Feb	5473 -	692163	727257	1500.-	116874	177711	89072
March	5133	392163	975711	1500.-	110949	177711	81157
April	5036	342163	957595	168750	105024	177711	73242
May	5148	292163	733326	168750	99099	177711	65327
June	5343 -	292163	820043	168750	93174	177711	57412
July	5118	292163	1112020	1835.-	87249	177711	
Aug	5198	142163	906408	[illegible]	81324	177711	
Sept	4693		947407	[illegible]	75399	177711	
Oct	5516		1019949	206250	69474	177711	
Nov	5077		841775	206250	63549	177711	
Dec	5133		726379	206250	57624	177711	

Tax Rate 1942 — 3.02 — 275,500 — 1408.48?
Tax Rate 1943 — 3.79 — 248,300 — 14136 30
1944 — 4.17 — [illegible] 300 — 12 [illegible] 48
1945 — 4 — 4.12 — [illegible] — 13 [illegible]
1946

[illegible] Due [illegible]at	Conditional Bills & [illegible] Refrigerators	Old Accounts Payable	Insurance Loan Payable to Bank		Total
750.	1-88 99	1777 11	2412 64		20737 67
750.	1929 74	1777 11	2333 49		20165 32
750.	1870 49	1777 11	2254 34		21151 47
3750	1811 24	1777 11	2175 19		2012421
3750	1151.99	1777 11	2096 04		20948 31
3750	1692 74	1777 11	2016 89		22933 66
125. -	1633.49	1777 11	1444 77		23482 20
125 -	1574 24	1777 11	1365 62		21140 39
125 -	1[illegible]14 99	1777 11	1286 47		21645 72
[illegible]2.50	1155.74	1777.11	1207 32		24429.76
[illegible]2 50	1396 49	1777 11	1128 17		24273 86
[illegible]50	1337 24	1777 11	1049 02		21949 91
500. -	1227 99	1777 11	969 87		22813 39
500. -	1168 74	1777 11	890 72		19530 77
500. -	1109.49	1777 11	811 57		18876 91
[illegible]750	1050 24	1777 11	732 42		18244 85
[illegible]750	990 99	1777 11	653 27		15363 76
[illegible]750	931.74	1777 11	574 12		16092 53
[illegible]5. -	872 49	1777 11			18566 43
[illegible] -	813 24	1777 11			14951 16
[illegible] -	753 99	1777 11			13880 17
[illegible]250	694 74	1777 11			14733 64
[illegible]250	635 49	5777 11			1[illegible]892 85
[illegible]250	576 24	5877 11			15779 64

[fol. 86] IN UNITED STATES DISTRICT COURT

FINDINGS OF FACT AND CONCLUSIONS OF LAW OF REFEREE PETER B. OLNEY

[Same Title]

I, Peter B. Olney, the Referee in charge of the above entitled matter, do hereby make the following Findings of Fact and Conclusions of Law:

FINDINGS OF FACT

1. Manufacturers Trust Company (hereinafter referred to as "Manufacturers") is a corporation duly organized and existing under the laws of the State of New York, and has its principal office at No. 55 Broad Street, in the Borough of Manhattan, City and State of New York.

2. Heretofore under an indenture dated February 1, 1927, by and between Empire Bond & Mortgage Corporation and the American Trust Company (thereafter merged with Bank of Manhattan Trust Company on October 30, 1930), the said Empire Bond & Mortgage Corporation issued its so-called First Mortgage 6% Participation Gold Bond Certificates in the principal amount of $575,000 secured by a first mortgage on the Calton Court Apartments, being an apartment house located in New Rochelle, Westchester County, New York.

3. Thereafter by reason of default in the payment of taxes and monthly instalments on account of principal and interest, a foreclosure proceeding was instituted by the corporate trustee of said mortgage. By reason of such foreclosure proceedings, and on or about April 25, 1932, a protective committee for the holders of said Gold Bond Certificates was organized and Manufacturers was named and acted as depositary for said committee.

[fol. 87] 4. Thereafter under date of July 1, 1933 a plan of reorganization was promulgated by said committee and in pursuance of said plan, on September 8, 1933, the said premises were sold at foreclosure and bid in by the committee for the sum of $93,000. At the time of the sale unpaid taxes, penalties and liens, other than the lien of the mortgage, aggregated in excess of $91,000. In payment of the amount bid upon the sale, the committee de-

livered to the corporate trustee $513,600 face amount of said Gold Bond Certificates deposited with the committee.

5. In further pursuance of said plan, the Debtor herein was organized to take title to said premises.

6. It was provided by the plan that the new company (the Debtor) would create an issue of debentures in a principal amount aggregating 50% of the principal amount of certificates deposited or which should be deposited with the committee, such debentures to be issued in denominations of $50, $100, $500 and $1000, to be registered as to both principal and interest, to be dated as of the date of delivery of the deed by the referee in foreclosure to the New Company, and to mature twenty (20) years from the date thereof. It was further provided that said debentures should bear interest at a rate not exceeding six percent per annum as the directors in their sole discretion should declare out of the net earnings of each calendar year.

It was further provided that under the plan of reorganization each assenting depositor should receive $50 of such debentures and one share of no par value stock of the New Company for each $100 principal amount of the certificates of deposit, and that no debentures or stock should be issued except to such depositors.

[fol. 88] 7. Thereafter and on September 27, 1933 said premises were duly conveyed to the Debtor and said Debtor entered into an indenture with Manufacturers as Trustee, providing for the issuance of its debentures provided for in the plan and due September 27, 1953. Said indenture continues in force and effect, and the Manufacturers has at all times acted and is still acting as trustee thereunder.

8. In pursuance of said plan and under the terms of said indenture there were issued and are outstanding $254,450 principal amount of said debentures, and there remain unexchanged $4700 principal amount of certificates of deposit, convertible into $2350 principal amount of such debentures, or a total authorized of $256,800 principal amount of debentures.

9. At the time of the issuance of the securities of the Debtor in pursuance of the plan and indenture, there were 205 holders of outstanding certificates of deposit.

10. In further pursuance of the plan, the Debtor borrowed the sum of $175,000 from Poughkeepsie Savings Bank of Poughkeepsie, New York, secured by a first mortgage on the said premises, upon which mortgage there is now due and unpaid the sum of $154,000 principal amount.

11. In pursuance of the provisions of the plan, the first directors of the Debtor were selected by the said committee, and said directors in turn elected its first officers.

12. During the years 1942, 1943 and 1944 the debtor was in a precarious condition, operating continually at a loss.

13. The financial condition of the debtor was duly disclosed from time to time to the stockholders at stockholders [fol. 89] meetings and on other occasions to individual stockholders and to the indenture trustee.

14. Early in the winter of 1942 debtor was in default under the terms of the first mortgage and it was clear that something had to be done.

15. A sale was negotiated by which Chesterbrook Estates agreed to buy debtor's property for $220,000 coupled with certain conditions as to satisfying conditional sales contracts.

16. This offer was favorably considered by debtor. One Sanford Becker, the holder of $5000 face amount of debentures and of 50 shares of stock, opposed said sale and brought a suit in the Supreme Court to enjoin it.

17. This suit was pending at the time of annual stockholders meeting in February, 1942, at which meeting the said offer failed to receive the necessary stockholders' approval.

18. At the same time Sanford Becker made an offer to the debtor to loan or cause to be loaned to it, $15,000 upon second mortgage. Becker's offer was conditioned upon his brother Norman Becker and himself being given control of the board of directors and the management of the debtor being put in the hands of "Trustee's Office", an organization which was attending to the management of various properties in Westchester County, the subject matter of certified mortgages which were being liquidated under Court supervision.

19. The debtor agreed to Mr. Sanford Becker's proposition, upon the condition however that stockholders be given [fol. 90] the opportunity to share in the said $15,000 second mortgage should they so desire. And Mr. Richard Kelly, president of the debtor, wrote a letter to the stockholders advising them of this opportunity. No stockholders availed themselves thereof except Regine Becker, mother, and Emily K. Becker, wife of Sanford Becker, and Walter A. Fribourg, a friend of the Becker brothers, and with whom he shared office space.

20. Accordingly in April 1942, the Baset Company was organized, the Becker ladies and Fribourg advancing to it the $15,000 in equal shares and the second mortgage was given. At the same time the Beckers became directors, Sanford becoming treasurer and Norman secretary of debtor, and the management was turned over to "Trustee's Office".

21. Thereafter in September, 1943, debtor being unable to pay $3615.54 taxes owing to City of New Rochelle, Baset advanced same. Again in April, 1944, debtor being again unable to pay taxes due to New Rochelle in the sum of $2305.09, Baset advanced same, and the same thing happened in October, 1944 in the sum of $2001, Baset likewise advanced this amount. In all there was advanced by Baset $7921.63. This indebtedness was repaid beginning September, 1944, by a payment of $100 and the balance was repaid in 1945.

22. Baset found after it had advanced the $15,000 that there were some $8000 of operating bills unpaid on the property which had to be thereafter taken care of from rents collected. Though debtor was in default under the terms of Baset mortgage from end of 1942 to time of sale [fol. 91] of property in January, 1946, Baset never foreclosed or even threatened to foreclose.

23. Baset did however, in October, 1943, take an assignment of rents.

24. Gradually under the better management of "Trustee's Office", the elimination of expense of bus service, the saving resulting in being able to convert back from coal to oil heating, and the general increased demand for apartment space following cessation of hostilities of World

War II, the debtor for the first time in years was able for the year 1945 to show a small operating surplus.

25. The assistance rendered to debtor by the Becker women and Fribourg through Baset materially helped debtor in weathering the grave financial situation through which it struggled.

26. Beginning November 8, 1941 and down to and including June 4, 1946, Walter A. Fribourg purchased debentures of debtor in the amounts, from or through the persons and for the prices and on the dates shown on objector's Ex. 11.

27. Regine Becker acting through her sons, beginning February 2nd, 1944 and down to and including October 30, 1945, purchased debentures of the debtor in the amounts on the dates and for the prices shown on objector's Ex. 12, from a dealer in securities, E. Henry Sondheimer Co.

28. Emily K. Becker through her husband Sanford Becker and her brother-in-law Norman Becker, from May 24, 1944 to February 5, 1945, purchased debentures of the [fol. 92] debtor in the amounts and on the dates and for the prices shown and from the persons shown on objector's Ex. 13.

29. In purchasing the debentures purchased by him, Fribourg who was in the market to purchase and purchased other securities of a speculative nature, was influenced in buying debtor's debentures in part because the assessed valuation was some $421,630 (S. M. 109). The purchase was for him just a gamble, a speculation (S. M. 108, 115).

30. There is no evidence to support a finding that Fribourg in connection with his purchases was acting on any information of an inside nature imparted to him by any officer or director of debtor—something not known to and of which the stock holders were not informed.

31. Norman Becker never purchased any of the debentures. He was pessimistic about the future of the debtor, in part because of his particular knowledge of the debtor's property, living as he did in New Rochelle, he was dis-urbed about the political situation, there being an influx of negro population within 10 blocks. He discussed his view point

both with his mother Regine Becker and with Fribourg (S. M. 385).

32. On the other hand Sanford Becker was optimistic about the future of debtor's property, even when its financial condition was precarious. He felt that after World War II conditions in the real estate field would approximate those following World War I, and result in an enhancement of the value of property, such as that of the debtor (S. M. 487-8).

As a matter of fact the evidence establishes that San- [fol. 93] ford Becker was right in expecting an enhancement of the value of debtor's property after the cessation of hostilities.

33. In October 1945 the Debtor made a contract for the sale of said premises, and thereafter and in pursuance of such contract said property was conveyed on January 8, 1946 to one Calton Properties, Inc. for a total sales price of $300,000 paid as follows:

> Subject to the said first mortgage to the Poughkeepsie Savings Bank in the then unpaid principal balance of $154,000; by cash of $70,000 and by purchase money mortgage to the Debtor of $76,000.
>
> From the proceeds of said sale, the Debtor satisfied the second mortgage to Baset Realty Corporation and paid a brokerage commission of $6000, leaving cash remaining from the said proceeds of sale of approximately $50,000.

34. The purchase money mortgage hereinabove referred to was thereafter sold pursuant to an order of this Court for the sum of $66,000, resulting in a total cash in the possession of the Debtor of $118,662.17 prior to administration expenses.

35. On May 23, 1946, debtor filed an arrangement petition under Chapter XI of the Bankruptcy Act.

36. In this proceeding by order of the Referee entered upon the confirmation of an amended plan of arrangement herein there was directed to be paid to the general creditors, including the debenture holders of the debtor, amounts equivalent to 43-61/100% of the principal amount of their claims.

[fol. 94] 37. In said arrangement proceeding, Emily K. Becker filed a proof of debt in the sum of $52,800, Regine Becker filed a proof of debt in the sum of $44,500 and Walter A. Fribourg filed a proof of debt in the sum of $55,000, said amounts being the respective aggregate of the face amount of debentures purchased by them as aforesaid.

38. Manufacturers filed objections to said claims on the ground that said debentures were acquired at a small percentage of par by persons in control of the debtor, concealing material facts and without fair disclosure to the other debenture holders—over-reaching. Objector claims that it would be inequitable to allow these claims, at more than the respective aggregate amount paid by them for their debentures. Upon the hearings the objector withdrew its objection to $5000 of the Fribourg claim, being debentures for the face amount of $5000 purchased on November 8, 1941 and March 28, 1942 for $230 and $250 respectively, that is, for a sum of $480 before the Beckers became directors.

39. Though pressed by the Referee to do so, the only facts pointed out by objector which it claims should have been disclosed, were so-called offers to purchase debtor's property after the Spring of 1942 in an ever increasing amount.

40. The record does not warrant a finding of offers to purchase the debtor's said property for sums increasing in amount from the Spring of 1942.

41. All that the record establishes in this respect is that since the Spring of 1942, brokers from time to time in making inquiries about debtor's property mentioned certain [fol. 95] figures as a possible purchase price. For example, in the course of these inquiries a broker said that he thought he could get $240,000 for the property. He was asked to submit an offer in writing but that was the last heard of it (S. M. 90). In or about November, 1944, a broker named Rubin purported to make an offer of $250,000 in behalf of one Solomon about whom no information could be obtained (S. M. 348). In 1945 a broker in behalf of an undisclosed principal, made an inquiry as to whether an offer of $280,000 would be accepted. To this inquiry the answer was "No", the debtor at the time

feeling that in view of the market it should try for $300,000 (S. M. 349-350).

42. In 1944, Manufacturers the indenture trustee, had their representative inspect the property, and at Manufacturers request a broker who thought he might be able to sell the property, made an investigation aided by debtor; but no offer was forthcoming (S. M. 379-80). Mr. Sterling B. Jordan, representative of Trustee's Office when management was in their hands, saw several brokers regarding their effecting a sale and gave them information. He asked them to submit offers. None did during the three years of Trustee's Office's management (S. M. 448-9).

43. From the time that the Chesterbrook Estate offer was turned down until the time of the sale in 1946, nothing which would be called an actual firm offer was made for debtor's property.

44. In the Spring of 1944, Mr. Richard Kelly, president of debtor and a debenture holder, had a conversation with Mr. Sanford Becker in which he expressed his wish to [fol. 96] withdraw from the whole picture and to sell his debentures because of the hopelessness of the situation. Mr. Kelly at the time told Mr. Sanford Becker that Mr. William Henry Hays, vice president and a debenture owner, felt the same way. Further, Mr. Kelly told Mr. Becker that if he could find someone who would buy their stock and debentures he, Kelly, and Hays, would be glad to get out. Accordingly Becker spoke to Fribourg who caused his brother-in-law Charles G. Winter, to collaborate with Mr. Kelly in writing a letter to debtor offering to purchase debentures for a unit price of 3% of par value (Objector's Ex. 14).

45. On May 13, 1944, Mr. Kelly wrote a letter to stockholders (Objector's Ex. 15), enclosing a copy of the Winter letter advising stockholders and calling attention to the debtor's bad financial condition and stating that he expected to accept Mr. Winter's offer (S. M. 301-307).

46. No satisfactory explanation was given why Fribourg caused his offer to be made through his brother-in-law Winter (S. M. 134, 161, 171).

47. Fribourg on May 25, 1944 purchased $15,250 face value of debentures, $8250 from Kelly. In July and August,

1944, he purchased $21,250 face value more including $8500 from William Henry Hays (Objector's Ex. 11).

48. On May 5 and 9, 1944, there was purchased for Regine Becker from E. Henry Sondheimer Co. $4000 face value of said debentures. And on May 24 and June 8, 1944, there was purchased for Emily K. Becker through said E. Henry [fol. 97] Sondheimer Co. $2500 face value of debentures on each date, $5000 in all (Objector's Exs. 12 & 13).

49. The debentures purchased for the Becker ladies from E. Henry Sondheimer Co. were in the first instance purchased for Fribourg and taken for the Becker ladies when Fribourg said he did not care to take them up (S. M. 211 to 229)

50. Norman Becker attended to the purchase for Emily K. Becker on November 16, 1944 of $37,500 face value of debentures belonging to the estate of one King through the Estate's attorneys, Reynolds, Richards & McCutcheon for 10% of the face value. The record indicates that the King Estate had kept fully informed of debtor's affairs and its financial condition and were anxious to sell the Estate's debentures (S. M. 296-9, 381-4, 389, 394, Respondent's Ex. 6).

51. Norman Becker attended to the purchase for Emily K. Becker on January 5, 1945, of $7550 face value of debentures from Young Women's Christian Association for 10% and the record indicates that Young Women's Christian Association through one Clay, a member of its investment committee, had kept fully informed of debtor's affairs and its financial condition and desired to sell its holdings for 10% (S. M. 300, 390-2, 481).

52. In June, 1944, Mr. Kelly resigned as president and director, and Norman Becker became president of debtor.

53. Sanford Becker and Norman Becker acted as agents for the Becker ladies in the purchase of debentures by them. [fol. 98] And while Sanford consulted with his mother and wife from time to time as to such purchases, the proof does not warrant a finding that the ladies exercised any discretion of their own in such purchases.

54. The record does not warrant a finding that in the purchases of debentures by the Becker ladies or Fribourg there was practiced any over-reaching or concealment or

failure to disclose to any other debenture holders material facts.

55. At all times when purchases of debentures were made by or for the Becker ladies and Fribourg, debtor was insolvent in that the aggregate of its property was not at a fair valuation sufficient in amount to pay its debts.

56. At none of the times when any debentures, which were by their terms due September 27, 1953, were purchased by or for the Becker ladies and Fribourg, had a special fund been provided for their payment by debtor; nor had any special liquidation thereof been ordered; nor was debtor in the field to settle its indebtedness on the debentures, or were these purchases unfair to debtor nor did they involve any competition with it.

Conclusions of Law

First: Upon the facts as found in passing on the proof of debt of Walter A. Fribourg, his proof of debt should not be treated as if it were a proof of debt filed by a director of debtor.

Second: Objections to the claim of Walter A. Fribourg should be dismissed and his proof of debt should be allowed for the full amount thereof, namely $55,000.

[fol. 99] Third: Upon the facts as found in passing on the proofs of debt of Emily K. Becker and Regine Becker, their proofs of debt should be treated as if they were proofs of debt filed by directors of debtor.

Fourth: Further upon the facts as found, objections to the proofs of debt of Emily K. Becker and Regine Becker should be dismissed and their claims should be allowed for the respective amounts thereof, namely: Emily K. Becker's proof of debt allowed for $52,800 and Regine Becker's proof of debt allowed for $44,500.

Fifth: Costs should be taxed against Manufacturers for the debtor's copy of the stenographic minutes, namely the sum of $218.90.

Settle order on notice in accordance with these Findings.

Dated, New York, July 2nd, 1947.

Peter B. Olney, Referee.

[fol. 100] IN UNITED STATES DISTRICT COURT

MEMORANDUM OF LAW OF REFEREE PETER B. OLNEY

[Same Title]

I, Peter B. Olney, the Referee in charge of the above entitled matter, do hereby file my Memorandum of Law as to the objections to the claims of Emily K. Becker, Regine Becker and Walter A. Fribourg.

The law seems to be well settled that a director may acquire for himself unmatured obligations of the corporation of which he is a director and enforce same for the full face amount thereof, even if at the time he so acquired said obligations the corporation is insolvent, provided that at said time the debtor had not provided any special fund to pay said obligation, nor any special liquidation had been ordered through the institution of Receivership or kindred proceedings, nor was the debtor in the field to settle its said obligations, nor was the acquiring of such obligations by the director unfair to the debtor nor involved competition with it, and again provided of course, that in acquiring such obligations the director was not guilty of over-reaching by unfairly using his special knowledge in dealing with those from whom he acquired the obligations.

Seymour v. Spring Forest Cemetery Ass'n., et al., 144 N. Y. 333.

Claire Neon Lights, Inc. v. Federal Electric Co. Inc., 250 App. Div. N. Y. 510, 517.

Nauben v. Morris, 255 App. Div. N. Y. 35, 46 affd. 281 N. Y. 652.

Ripperger v. Allyn, D.C.N.Y. 25 Fed. Sup. 554.

Compare Securities Exchange Commission v. Chenery Corp., 318 U. S. 80, 85-86, 1943.

The cases relied upon by objector will upon examination of the facts be found to contain one or more of the ele-[fol. 101] ments referred to above which preclude a director from enforcing at their face amounts obligations of his corporation acquired by him.

In Los Angeles Lumber Products Co. D. C. S. D. Cal., Central Division, 46 Fed. Supp. 77, 1941, upon which objector greatly relied, a director acquired obligations of a

debtor after it had become insolvent and reorganization had been authorized.

This decision does not sustain objector's contention that insolvency alone is sufficient to preclude a director's acquiring his corporation's obligations and enforcing same for their face amount as distinguished from the amount paid for them only.

In so far as anything said in Los Angeles Lumber Products Co. tends to support objector's contention, it is at variance with the other cases cited above and with the principles laid down in Securities Exchange Commission v. Chenery, supra, and cannot be taken as an authority for objector's contention.

Dated, New York, July 2nd, 1947.

Peter B. Olney, Referee.

[fol. 102] IN UNITED STATES DISTRICT COURT

ORDER OF REFEREE PETER B. OLNEY

[Same Title]

Walter A. Fribourg having filed his proof of debt herein in the sum of $55,000; and Emily K. Becker having filed her proof of debt herein in the sum of $52,800; and Regine Becker having filed her proof of debt herein in the sum of $44,500; and objections thereto having been filed by the Manufacturers Trust Company, individually and as Indenture Trustee; and a hearing on the said objections having thereafter come on to be heard before me; and the objector and the claimants having submitted their respective proofs; and findings of fact and conclusions of law having thereafter been made by me dated July 2, 1947; and upon filing my memorandum opinion dated the same date, it is now

Ordered: That the aforementioned objections filed by the Manufacturers Trust Company, individually and as Indenture Trustee, be and the same hereby are dismissed, and the claims of the said Walter A. Fribourg, Emily K. Becker and Regine Becker be and the same hereby are allowed as filed in the sums respectively of $55,000, $52,800 and $44,500; and it is further

Ordered: That the cost of the stenographer's minutes paid by the debtor in the sum of $218.90 shall be taxed against the Manufacturers Trust Company, the objector.

Dated, New York, July 11th, 1947.

Peter B. Olney, Referee in Bankruptcy.

[fol. 103] IN UNITED STATES DISTRICT COURT

PETITION FOR REVIEW

[Same Title]

To the Honorable Peter B. Olney, Referee in Bankruptcy:

The petition of Manufacturers Trust Company, a creditor of the Debtor, individually and as Indenture Trustee, respectfully represents:

1. Your petitioner is aggrieved by the order herein of the Honorable Peter B. Olney, Referee in Bankruptcy, dated July 11, 1947, a copy of which order is annexed hereto, marked Exhibit A, and made a part hereof.

2. The Referee erred in respect to said order in that in his finding of fact numbered 12 he failed to find that the Debtor was in a precarious condition during the year 1945 as the evidence clearly shows.

3. The Referee erred in respect to said order in that the Referee's finding of fact numbered 13, stating that the financial condition of the Debtor was fully disclosed from time to time to the stockholders at stockholders' meetings and on other occasions to individual stockholders and to the Indenture Trustee, was clearly erroneous and further that the Referee erred in failing to find that the maximum number of stockholders present in person at any of such meetings, other than the directors, their nominees and their associates (the three creditors here involved) was three and that no disclosure was made at any such meeting of the inquiries and offers received with a view to the purchase of the property of the Debtor.

4. The Referee erred in respect to said order in that the Referee's findings of fact numbered 18, 19 and 20, stating in substance that Sanford Becker had made an offer

to loan the Debtor $15,000 upon the condition that he and his brother be given the control of the Debtor; that the [fol. 104] Debtor agreed to the aforesaid proposition upon the condition that the stockholders be given an opportunity to share in this $15,000 loan which was to be secured by a second mortgage; that no stockholders except the three creditors here involved availed themselves of the opportunity of making such loan; and that the three creditors here involved accordingly formed the Baset Company to make such loan of $15,000, were clearly erroneous, and the Referee further erred in failing to find that Sanford Becker early in 1942 was cognizant of the financial embarrassment of the Debtor and, seeing an opportunity to obtain control of the Debtor at a nominal expense, caused a group consisting of the three creditors here involved to be formed in order to obtain such control; that in pursuance of such plan to obtain control of the Debtor, Sanford Becker, at the stockholders' meeting held in February, 1942, stated on behalf of this group, whose identity he did not disclose, that he had a client who would loan $15,000 to the Debtor to be secured by a second mortgage loan on the Debtor's property; that this offer made by Sanford Becker's clients was accepted; that it was not until after its acceptance, when it was apparent that none of the other stockholders were interested in making such loan, that the stockholders as a group were given an opportunity to participate therein; and accordingly Sanford Becker and the aforesaid group, being the three creditors here involved, were thus able to gain control of the Debtor.

5. The Referee erred in respect to said order in that the Referee's finding of fact numbered 29, stating that in purchasing the debentures purchased by him Fribourg was in the market to purchase and purchased other securities [fol. 105] of a speculative nature and was influenced in buying the Debtor's debentures in part because the assessed valuation of the Debtor's property was some $421,630 and that the purchase was for him just a gamble and a speculation, was clearly erroneous and further that the Referee erred in failing to find that Fribourg was affiliated with Messrs. Becker and was apprised by them of all facts and circumstances in connection with the inquiries and offers being made with a view to the purchase of the Debtor's property and that accordingly his purchases of

the Debtor's debentures was not based in part upon the assessed valuation of the Debtor's property but upon inside information received by him from the directors and officers of the Debtor.

6. The Referee erred in respect to said order in that the Referee's finding of fact numbered 30, stating that there was no evidence to support a finding that Fribourg in connection with his purchases was acting on any information of an inside nature imparted to him by any officer or director of the Debtor, i. e., something not known to and of which the stockholders were not informed, was clearly erroneous.

7. The Referee erred in respect to said order in that the Referee's finding of fact numbered 31, stating that Norman Becker was pessimistic about the future of the Debtor, in part because of his particular knowledge of the Debtor's property, living as he did in New Rochelle, and that he was disturbed about the political situation, there being an influx of negro population within ten blocks and that he discussed his viewpoint both with his mother Regine Becker and with Fribourg, was clearly erroneous.

[fol. 106] 8. The Referee erred in respect to said order in that the Referee's finding of fact numbered 32, stating that Sanford Becker was optimistic about the future of the Debtor's property even when its financial condition was precarious and felt that after World War II conditions in the real estate field would approximate those following World War I and result in an enhancement of the value of property, such as that of the Debtor, and that the evidence established that Sanford Becker was right in expecting an enhancement of the value of the Debtor's property after the cessation of hostilities, was clearly erroneous, inasmuch as said finding fails to give effect to the special knowledge and information possessed by Sanford Becker as an officer and director of the Debtor.

9. The Referee erred in respect to said order in that the Referee's finding of fact numbered 38, stating that Manufacturers Trust Company filed objections to said claims on the ground that said debentures were acquired at a small percentage of par by persons in control of the Debtor, concealing material facts and without fair disclosure to the other debenture holders—overreaching, was clearly errone-

ous and further the Referee erred in failing to find that Manufacturers Trust Company filed objections to said claims on two grounds; namely, to wit: that said debentures were acquired by relatives, associates and affiliates of the directors and officers of the Debtor on behalf of some of whom the said directors and officers acted as agents while the Debtor was insolvent; and further as a separate and distinct objection, that while the Corporation was insolvent such persons acquired these debentures while concealing material facts and without appropriate and fair disclosure to the sellers thereof of the facts in connection with the situation.

[fol. 107] 10. The Referee erred in respect to said order in that the Referee's finding of fact numbered 39, stating that the only facts pointed out by the objector which it claims should have been disclosed were so-called offers to purchase the Debtor's property after the Spring of 1942 in an ever increasing amount, was clearly erroneous and further that the Referee erred in failing to find that the evidence established that inquiries with a view to the purchase of the Debtor's property were being received at least once a month, that two bona fide offers were received and that such inquiries and offers indicated a rising value of the Debtor's property.

11. The Referee erred in respect to said order in that the Referee's finding of fact numbered 40, stating that the record does not warrant a finding of offers to purchase the Debtor's property for sums increasing in amount from the Spring of 1942, was clearly erroneous.

12. The Referee erred in respect to said order in that the Referee's finding of fact numbered 41, stating that all that the record establishes in respect to the aforementioned so-called offers is that since Spring 1942 brokers from time to time in making inquiries about the Debtor's property mentioned certain figures as a possible purchase price, for example, in the course of these inquiries a broker said that he thought he would get $240,000 for the property for which he was asked to submit an offer in writing but that was the last heard of it; that in or about November, 1944, a broker named Rubin purported to make an offer of $250,000 in behalf of one Solomon about whom no information could be obtained; that in 1945 a broker in behalf of an undisclosed

principal made an inquiry as to whether an offer of $280,000 [fol. 108] would be accepted, to which inquiry the answer was "No", the Debtor at the time feeling that in view of the market it would try for $300,000, was clearly erroneous.

13. The Referee erred in respect to said order in that the Referee's finding of fact numbered 43, stating that from the time that the Chesterbrook Estates offer was turned down until the time of the sale in 1946 nothing which could be called an actual firm offer was made for the Debtor's property, was clearly erroneous, and further that the Referee erred in failing to find that two firm offers were made for the Debtor's property between the date of the Chesterbrook Estates offer and the offer which was finally accepted.

14. The Referee erred in respect to said order in that the Referee's finding of fact numbered 44, stating that in the Spring of 1944 Mr. Richard Kelly, president of the Debtor and a debenture holder, had a conversation with Sanford Becker in which he expressed his wish to withdraw from the whole picture and to sell his debentures because of the hopelessness of the situation; that Mr. Kelly at the time told Sanford Becker that Mr. William Henry Hays, vice president and a debenture holder, felt the same way; that Kelly told Sanford Becker that if he could find someone who would buy their stock and debentures, he, Kelly, and Hays would be glad to get out and that accordingly Becker spoke to Fribourg who caused his brother-in-law Charles G. Winter to collaborate with Kelly in writing a letter to the Debtor offering to purchase debentures for a unit price of 3% of par value, was clearly erroneous, and further that the Referee erred in failing to find that Fri- [fol. 109] bourg, seeking to purchase more securities of the Debtor, persuaded his brother-in-law, Charles G. Winter to make an offer for such securities through the Corn Exchange Bank, had Norman Becker introduce the said Charles G. Winter to said Bank and that thereupon Fribourg purchased through the medium of Charles G. Winter certain securities of the Debtor without in any manner disclosing to the sellers thereof the true facts in connection with the Debtor's property or his connection with the Debtor's directors and officers.

15. The Referee erred in respect to said order in that the Referee's finding of fact numbered 50, stating that the record indicates that the King Estate had kept fully informed of the Debtor's affairs and its financial condition and were anxious to sell the Estate's debentures, was clearly erroneous, and further that the Referee erred in failing to find that the King Estate had not been furnished with any information with respect to the inquiries and offers received with a view to the purchase of the Debtor's property.

16. The Referee erred in respect to said order in that the Referee's finding of fact numbered 51, stating that the record indicates that the Young Women's Christian Association through one Clay, a member of its investment committee, had kept fully informed of the Debtor's affairs and its financial condition and desired to sell its holdings for 10% was clearly erroneous, and further that the Referee erred in failing to find that the representatives of the Young Women's Christian Association had not been furnished any information with respect to the inquiries and offers which were received with a view to the purchase of the Debtor's property.

[fol. 110] 17. The Referee erred in respect to said order in that the Referee's finding of fact numbered 54, stating that the record does not warrant a finding that in the purchase of debentures by the Becker ladies or Fribourg there was practiced any overreaching or concealment or failure to disclose to any other debenture holders material facts, was clearly erroneous and further that the Referee erred in failing to find that in the purchase of the debentures by Mesdames Becker or Fribourg there had been overreaching, concealment and failure to disclose to the sellers of such debentures material facts in connection with the property of the Debtor.

18. The Referee erred in respect to said order in that the Referee failed to find that the Debtor was insolvent in the equity sense from 1942-1945, inclusive, in that it could not pay its debts as they matured in the ordinary course of business.

19. The Referee erred in failing to find that the acquisition of the Debtor's debentures by the Mesdames Becker and Fribourg was a concerted plan of acquisition which

the participants therein knew would result in a profit to them by virtue of information which they had received from directors and officers of the Debtor.

20. The Referee erred in failing to find that the Mesdames Becker, through their agents, and Fribourg, in order to obtain the debentures and to carry out their concerted plan of acquisition of the same, conducted a circularization campaign through Sondheimer & Company on the basis of a list of security holders furnished by Fribourg and solicited the sale of the same in the name of Charles G. Winter, the necessary funds being supplied by Fribourg.

[fol. 111] 21. The Referee erred in failing to find that Mesdames Becker and Fribourg deliberately concealed their identities when purchasing the Debtor's securities by use of the circularization campaign conducted through Sondheimer & Company and by the solicitation in the name of Charles G. Winter heretofore mentioned.

22. The Referee erred in failing to find that the sellers of the debentures were in every instance stockholders as was known by all participants in the matter and that no annual report to stockholders was furnished after the year 1943, and the annual report for the year 1943 was in the form of a postscript to the notice of the annual stockholders meeting and contained no information with respect to any of the developments which had occurred in connection with the Debtor's property.

23. The Referee erred in respect to said order in that the Referee's conclusion of law numbered First, holding that Walter A. Fribourg's proof of debt should not be treated as if it were a proof of debt filed by a director of the Debtor, was clearly erroneous. The error consists in the fact that the Referee disregarded well-established principles of law that not only are directors and officers of an insolvent corporation disqualified from profiting by transactions in said insolvent debtor's securities which they acquired by taking advantage of their knowledge as insiders without appropriate disclosure to the sellers of such securities and therefore are not allowed to profit by reason of their overreaching but also the same principles apply to persons who are associated with them and who are not officers or directors.

24. The Referee erred in respect to said order in that the Referee's conclusion of law numbered Second, hold- [fol. 112] ing that the objections to the claim of Walter A. Fribourg should be dismissed and his proof of debt should be allowed for the full amount of $55,000, was clearly erroneous. The error consists in the fact that the Referee disregarded well-established principles of law that directors of an insolvent corporation and persons affiliated with them, related to them or acting in conjunction with them, can not profit from any dealings in securities of said insolvent corporation, and, in conjunction therewith, or in the alternative, that they may not profit on purchases of securities of the insolvent debtor which they acquired by taking advantage of their knowledge as insiders without appropriate disclosure to the sellers of such securities and therefore are not allowed to profit by reason of their overreaching, and that at best they may recover from the estate of the Debtor only the amounts actually expended by them with interest.

25. The Referee erred in respect to said order in that the Referee's conclusion of law numbered Fourth, holding that the objections to the proofs ~~of debt~~ of Emily K. Becker and Regine Becker should be dismissed and their claims should be allowed for the respective amounts of $52,800 and $44,500, was clearly erroneous. The error consists in the fact that the Referee disregarded well-established principles of law that directors of an insolvent corporation and persons affiliated with them, related to them or acting in conjunction with them, can not profit from any dealings in securities of said insolvent corporation, and, in conjunction therewith, or in the alternative, that they may not profit on purchase of securities of the insolvent debtor which they acquired by taking advantage of their knowledge as insiders without appropriate disclosure to the sellers of such securities and therefore are not allowed [fol. 113] to profit by reason of their overreaching, and that at best they may recover from the estate of the Debtor only the amounts actually expended by them with interest.

26. The Referee erred in respect to said order in that the Referee failed to find as a conclusion of law that because the Debtor was insolvent at all times during the years 1942-1946, both inclusive, the directors and persons affiliated with them, related to them or acting in conjunction

with them, can not profit from any dealings in securities of the Debtor, and that at best they may recover from the estate of the Debtor only the amounts actually expended by them with interest.

27. The Referee erred in respect to said order in that the Referee failed to find as a conclusion of law that the three creditors are disqualified from profiting by transactions in the Debtor's securities, because they acquired the debentures in question by taking advantage of their knowledge as insiders without appropriate and adequate disclosure to the sellers of such securities and therefore should not be allowed to profit by reason of their overreaching.

28. The Referee erred in respect to said order in that the Referee's conclusion of law numbered Fifth, holding that costs should be taxed against Manufacturers for the Debtor's copy of the stenographic minutes in the sum of $218.90 was clearly erroneous, inasmuch as the objections of Manufacturers, as amended upon the hearing thereon, should have been sustained, and further that the Debtor was not an adverse party to this proceeding and consequently did not require a copy of said minutes.

[fol. 114] Wherefore your petitioner prays that said order be reviewed by a judge in accordance with the provisions of the Act of Congress relating to Bankruptcy and the General Orders applicable thereto, that said order be vacated and set aside, that Manufacturers' objections to the proofs of debt of Walter A. Fribourg, Emily K. Becker and Regine Becker, as amended, be sustained, and that the petitioner have such other and further relief in the premises that may be just and proper.

Dated: New York, N. Y., July 18th, 1947.

Manufacturers Trust Company, Petitioner, by Frank P. Gage, Trust Officer.

Beckman & Bogue, by Leslie B. Soper, a Partner, Attorneys for Petitioner, No. 15 Broad Street, New York 5, New York.

(Verified by Frank P. Gage, July 18, 1947.)

(The Referee's order referred to in paragraph 1 of the foregoing petition is printed at page 102, *supra*, and therefore is here omitted.

[fol. 115] IN UNITED STATES DISTRICT COURT

CERTIFICATE OF REFEREE PETER B. OLNEY

[Same Title]

To the Honorable the Judges of the District Court of the United States for the Southern District of New York

I, Peter B. Olney, the Referee in charge of the above entitled proceeding, do hereby certify pursuant to Section 39 a(8) as follows:

The question certified for review is whether as Referee I erred in making the order dated July 11, 1947, sought to be reviewed and herewith submitted, in and by which I dismissed the objections to the claims of Walter A. Fribourg, Emily K. Becker and Regine Becker and allowed the same as filed in their respective sums. More specifically, error is claimed in that the Referee erred in his order in the respects set forth in the petition to review verified July 18, 1947, and submitted herewith, in that he erred in Findings 13, 18, 19, 20, 29, 30, 31, 32, 38, 39, 40, 41, 43, 44, 50, 51 and 54, and in failing to find as set forth in paragraphs 2, 18, 19, 20, 21 and 22 of said petition to review, and further erred in Conclusions of Law First, Second, Fourth and Fifth, and in failing to find Conclusions of Law in the respects set forth in paragraphs 26 and 27 of said petition to review.

The facts are as found in Referee's Findings of Fact and Conclusions of Law dated July 2, 1947, herewith submitted.

There is also submitted herewith the following claims: Walter A. Fribourg in the sum of $55,000 verified October 28, 1946; Emily K. Becker in the sum of $52,800 verified October 23, 1946, and Regine Becker in the sum of $44,500 verified October 24, 1946; objections to said claims verified December 6, 1946; Referee's Memorandum of Law dated July 2, 1947, and stenographic record of the hearings [fol. 116] on said objections to said claims, and the exhibits.

Respectfully submitted, Peter B. Olney, Referee.

Dated, New York, July 23, 1947.

Hearing on above certificate will be on the bankruptcy motion calendar in the United States Court House, Foley

Square, New York City, on Wednesday, July 30th, 1947, at 10:30 A. M.

Peter B. Olney, Referee.

IN UNITED STATES DISTRICT COURT

OPINION OF GODDARD, D. J.

[Same Title]

GODDARD, District Judge:

This is a petition to review the order of a referee in bankruptcy overruling the objections of an Indenture trustee and creditor to the allowance of the claims in full of three creditors, Regine Becker, Emily K. Becker and Walter A. Fribourg. The claims are founded upon debenture bonds of the debtor corporation owned by the three creditors. The trustee contended that in each instance these claims should be limited to the amount paid by the creditor for such debentures.

The amounts of these claims as filed and allowed on which a dividend of 43.61% is contemplated, and the cost to [fol. 117] the creditors of the respective debentures which is the basis for their claims, are as follows:

	Amount and Allowance of Claim	Cost
Regine Becker	$44,500.	$3,060.63
Emily K. Becker	52,800.	5,010.00
Walter A. Fribougr	55,000.	2,604.80

The debtor owned and operated an apartment house in New Rochelle, New York, known as the Calton Court Apartments, which it had taken over upon default of a mortgage in September, 1933 and twenty years debentures in the amount of $256,800 were issued, the Manufacturers Trust Company [the objector] serving as Indenture trustee. A loan of $175,000 secured by a first mortgage was obtained from the Poughkeepsie Savings Bank. In 1941, prior to the time the Beckers became officers of the corporation which was in April, 1942, Sanford Becker and Fribourg, a friend of the Beckers, purchased some of the debentures in the open market. From 1941 until 1945 Regine Becker, mother, and Emily K. Becker, wife of

Sanford Becker, as well as others, purchased debentures in the open market. In 1942 the debtor, which had been operating at a loss, was in default on the mortgage held by the Poughkeepsie Bank and it was decided to obtain $15,000 on a second mortgage. All stockholders were given an opportunity to participate in making this loan, but the only ones who responded were Regine Becker, Emily K. Becker and Fribourg, who advanced the $15,000 in equal shares. In February, 1942 an offer of $220,000 was received for the property but failed to receive the necessary stock- [fol. 118] holders' approval. On January 8, 1946 the property was sold for $300,000 subject to the Poughkeepsie Bank's mortgage of $154,000, $70,000 in cash and the debtor taking back a purchase money mortgage of $76,000, which was sold by order of the court for $66,000, netting the debtor some $115,000 after satisfying the second mortgage of $15,000 and paying broker's commissions of $6,000.

On May 23, 1946 the debtor filed an arrangement petition under chapter XI of the Bankruptcy Act.

The trustee withdrew its objection to $5,000 of the Fribourg claim as these debentures had been purchased prior to the time the Becker-Fribourg group took over control of the debtor. The basis for the trustee's objections was twofold, namely—

[1] That the debtor was insolvent at all times during the years 1942-1945, both inclusive, when the debentures in question were acquired, and that the directors and persons, such as the three creditors, affiliated with them, related to them or acting in conjunction with them, cannot profit from any dealings in securities of the debtor, and at best may only recover the amounts actually expended, with interest, for the purchase of the debentures; [2] that the said three creditors are disqualified from profiting from transactions in the debtors' securities, because they acquired the debentures in question by taking advantage of their knowledge as insiders without appropriate and adequate disclosure to the sellers of such securities and therefore should not be allowed to profit by reason of their overreaching.

The referee held that "The law seems to be well settled that a director may acquire for himself unmatured obligations of the corporation of which he is a director and enforce same for the full face amount thereof, even if at

[fol. 119] the time he so acquired said obligations the corporation is insolvent, provided that at said time the debtor had not provided any special fund to pay said obligation, nor any special liquidation had been ordered through the institution of Receivership or kindred proceedings, nor was the debtor in the field to settle its said obligations, nor was the acquiring of such obligations by the director unfair to the debtor nor involved competition with it, and again provided of course, that in acquiring such obligations the director was not guilty of overreaching by unfairly using his special knowledge in dealing with those from whom he acquired the obligations."

The referee in rendering his opinion made detailed findings of fact to support his conclusions. Among these findings are the following:

> "54. The record does not warrant a finding that in the purchases of debentures by the Becker ladies or Fribourg there was practiced any overreaching or concealment or failure to disclose to any other debenture holders material facts.
>
> 55. At all times when purchases of debentures were made by or for the Becker ladies and Fribourg, debtor was insolvent in that the aggregate of its property was not at a fair valuation sufficient in amount to pay its debts.
>
> 56. At none of these times when any debentures, which were by their terms due September 27, 1953, were purchased by or for the Becker ladies and Fribourg, had a special fund been provided for their payment by the debtor; nor had any special liquidation thereof been ordered; nor was the debtor in the field to [fol. 120] settle its indebtedness on the debentures; nor were these purchases unfair to debtor nor did they involve any competition with it."

The referee found as a conclusion of law that Fribourg's proof of debt should not be treated as if it were a proof of debt filed by a director of the debtor. While it is immaterial to the disposition of this review, I am persuaded that the evidence warrants a finding that the relationship between Fribourg and the Beckers [directors] was of such a nature with respect to the affairs of the debtor so as to treat his proof of debt as a proof of debt of a director.

Although it is true that federal bankruptcy law, not state law, governs the distribution of a bankrupt's assets to its creditors [*Prudence Realization Corp.* v. *Geist*, 316 U. S. 89; *American Surety Co.* v. *Sampsell*, 327 U. S. 269; *Heiser* v. *Woodruff*, 327 U. S. 726; *Vanston Bondholders Protective Committee* v. *Green*, 329 U. S. 156] the validity of a claim, in the absence of overruling federal law, is determined with reference to state law. *Vanston Bondholders Protective Committee* v. *Green*, supra; *Remington on Bankruptcy*, Vol. 2, Sec. 975.

The law applied by the referee is the law of New York when the corporation is a going concern. *Moore Constr. Co.* v. *U. S. Fidelity & Guarantee Co.*, 293 N. Y. 119, 125; *Seymour* v. *The Spring Forest Cemetery Association, et al.*, 144 N. Y. 333; *Claude Neon Lights, Inc.* v. *Federal Electric Company, Inc.*, 250 App. Div. 510; *Hauben* v. *Morris*, 255 App. Div. 3, affirmed 281 N. Y. 652; *Ingelhart* v. *Thousand Islands Hotel*, 32 Hun 377; *Oelberman* v. *N. Y. & Northern R. Co.*, 14 Misc. 131.

The rule that directors and those who occupy a similar [fol. 121] position may acquire the unmatured obligations of a going concern and enforce the same for the full face amount if such purchase is fair to the corporation and involves no competition with the corporation, has been approved and followed in this district. *Ripperger* v. *Allyn*, et al., 25 Fed. Supp. 554; Patterson, D. J., Southern District of New York.

A group of cases have held that officers, directors and attorneys of a corporation may not, *while the corporation is insolvent*, purchase claims against it at a discount and then enforce such claims in a subsequent bankruptcy proceeding at their full face value. *Monroe* v. *Scofield*, 135 F. (2nd) 725; *In re Philadelphia & Western Ry. Co.*, 64 F. Supp. 738; *In re Los Angeles Lumber Products Co.*, 46 F. Supp. 77; *In Re McCrory Stores Corp.*, 12 F. Supp. 267; *In re Jersey Materials Co.*, 50 F. Supp. 428.

The above cases deal with situations where some type of bankruptcy proceeding was imminent and was known to be so by the officer, director, or person affiliated with them who made the purchases.

However, these cases do not seem to cover a situation where the corporation, although insolvent in a bankruptcy sense, is still a "going concern" for the mere fact that a

corporation is insolvent does not dissolve the corporation and make the directors mere trustees of its assets if it is still a "going concern". *White, Potter & Paige Mfg. Co.* v. *Pettes Importing Co.*, 30 Fed. 864; *Contra Costa Water Co. v. City of Oakland*, 113 P. 668, 682, 159 Cal. 323; *Public Market Co. of Portland* v. *City of Portland*, 130 F. (2nd) 624, 646, 171 Or. 522; *Michigan Wolverine Student Co-op.* v. *Wm. Goodyear & Co.*, 22 N. W. 2nd, 884, 888, 314 Mich. 580. This distinction as to the duty of a director when the corporation, although insolvent is [fol. 122] a going concern, was recognized in *Sanford Tool Co.* v. *Howe, Brown & Co.*, 157 U. S. 312; see *Asheville Lumber Co.* v. *Hyde*, 172 Fed. 730, 733.

In the case at bar these purchases were made when the corporation was a going concern and in later years even began to show an operating surplus Although the referee made a finding of insolvency, it does not appear that the referee in making this finding used a going concern valuation. *Pacific Lumber Co.* v. *Bargar*, 10 F. (2nd) 335; *In re Nathanson Bros. Co.*, 64 F. (2nd) 912.

At all the times that these purchases were being made these securities of the debtor were being traded in over the counter market. Under these circumstances the referee was right in applying the rule as laid down in the New York cases. The cases which appear to have language to the contrary are clearly distinguishable on their facts. The purchases of the debentures in question were made long before the filing of the petition under Chapter XI of the Bankruptcy Act, on May 23, 1946, or before contemplation of filing the petition, in some instances—months, and in others—years.

The referee further found that a finding that overreaching or concealment was practiced in the purchase of these securities was not warranted. The record does not show that this finding was clearly erroneous and hence must be confirmed. *General Order 47; In re Rosenberg*, 145 F. (2nd) 896, 898 (C. C. A. 2).

The referee's order including the taxation of the cost of stenographer's minutes is therefore confirmed in all respects.

Henry W. Goddard, U. S. D. J.

July 13, 1948.

[fol. 123] IN UNITED STATES DISTRICT COURT

ORDER OF GODDARD, D. J., HERE APPEALED FROM

[Same Title]

An order having been made herein by Referee Peter B. Olney, Referee in Bankruptcy, dated July 11, 1947, dismissing objections filed by Manufacturers Trust Company, individually and as Indenture Trustee, to the claims of Walter A. Fribourg, Emily K. Becker and Regine Becker, in the sums respectively of $55,000, $52,800 and $44,500, and allowing the said claims in such amounts; and the said Manufacturers Trust Company, individually and as Indenture Trustee, having thereafter filed a petition for the review of the said order; and the Referee having filed his certificate upon the said petition to review; and argument upon the said petition for review having come on before me on April 21, 1948; after hearing Messrs. Beekman & Bogue (Edward K. Hanlon, Esq., of counsel) in support of the petition to review; and David W. Kahn, Esq., attorney for the aforementioned claimants, in opposition; and due deliberation having been had, and upon filing the opinion dated July 13, 1948, it is on motion of David W. Kahn, attorney for the claimants,

ORDERED:

1. That the petition to review aforementioned be and the same hereby is denied and the order of Referee Olney, dated July 11, 1947, be and the same hereby is in all respects affirmed.

2. That the claimants herein be and they hereby are authorized to tax the cost of the stenographer's minutes paid by them, in the sum of $218.90, against the said Manufacturers Trust Company, individually and as Indenture Trustee, and to have judgment therefor.

Dated, New York, July 20, 1948.

Henry W. Goddard, U. S. D. J.

[fol. 124] In United States District Court

Notice of Appeal

[Same Title]

Sirs:

Notice is hereby given that Manufacturers Trust Company, individually and as indenture trustee, hereby appeals to the United States Circuit Court of Appeals for the Second Circuit from the order of this Court entered herein in this proceeding on July 21, 1948, affirming an order of Referee Peter B. Olney dated July 11, 1947, and from each and every part of the order appealed from.

Dated: New York, N. Y., August 4, 1948.

Yours, etc. Beekman & Bogue, Attorneys for Appellant, Manufacturers Trust Company, Office & P. O. Address, 15 Broad Street, New York 5, New York.

To: David W. Kahn, Esq., Attorney for Appellees, 120 Broadway, New York 5, New York;

Clerk of the United States District Court for the Southern District of New York.

[fols. 125-127] [File endorsement omitted]

IN UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

In the Matter of CALTON CRESCENT, INC., Debtor

MANUFACTURERS TRUST COMPANY as trustee under an Indenture made by the debtor under date of September 27, 1933 and individually, Objector-Appellant,

against

REGINE BECKER, EMILY K. BECKER and WALTER A. FRIBOURG, Claimants-Appellees

Appendix to Appellee's Brief—Filed December 31, 1948

[fol. 128] IN UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK

(In Bankruptcy)

No. 84,684

In the Matter of CALTON CRESCENT, INC., Debtor

EXTRACTS FROM STENOGRAPHIC MINUTES OF THE HEARING BEFORE REFEREE OLNEY

New York, December 30, 1946, 10:00 o'clock A. M.

Before: HON. PETER B. OLNEY, Referee.

HEARING OF OBJECTIONS TO CLAIMS OF WALTER A. FRIBOURG, EMILY K. BECKER AND REGINE BECKER

Proceeded Pursuant to Notice

APPEARANCES:

Messrs. Beekman & Bogue, Attorneys for Manufacturers Trust Company, Indenture Trustee, Objectant; by Edward K. Hanlon, Esq., of Counsel.

Messrs. Monfried & Monfried, Attorneys for Walter A. Fribourg, Emily K. Becker and Regine Becker, Respondents; by Richard M. Monfried, Esq., of Counsel, and David W. Kahn, Esq., of Counsel.

[fol. 129] EXTRACTS FROM TESTIMONY OF SANFORD BECKER

Page 37

By Mr. Hanlon:

Q. But you do remember that you felt that $220,000 was not enough money for this property in 1942?

A. I do know at that time my opinion was that if they sold it for two hundred and twenty they would receive nothing, so the best thing they could do would be to stay in business.

• • • • • • •

Pages 59-61

Q. These minutes of the directors' meeting on April 7, 1942, Objectant's Exhibit 8, in reference to this mortgage incorporate the letters from Mr. Myles B. Amend who was then counsel for the debtor, was he not?

A. I believe he was.

Q. In which he says: "I acknowledge receipt from Baset Realty Corporation of two checks of Sanford Becker, one for $12,500 and the other for $2,500, representing the loan to be secured by the bond and mortgage above referred to." You did deliver two checks, did you, to Mr. Amend in the amounts named and for the purpose stated?

A. Well, there would be more circumstances to that than that letter states.

Q. I am asking you a simple question. You delivered two checks to him?

A. I did not.

Q. What did you do with the two checks?

A. I gave—I collected the money for the mortgage.

The Referee: What did you do with the two checks?

The Witness: Gave it to Mr. Eisenberg as I stated.

[fol. 130] Q. Mr. Milton Eisenberg?

A. That is correct.

Q. He was representing you in the transaction?

A. He was representing the second mortgagees.

The Referee: To whom were the checks drawn?

The Witness: I imagine they were drawn to Calton Crescent.

Mr. Hanlon: I think that is so, your Honor.

Q. And from what source were the funds obtained?
A. From the three individuals.
Q. That is, your wife, your mother and Mr. Fribourg?
A. Mr. Fribourg.
Q. And the checks were your personal checks?
A. The checks were drawn on my special account.
Q. On your special account?
A. Yes.

The Referee: Did Mr. Fribourg, your wife and your mother have bank accounts?

The Witness: Yes, sir.

The Referee: Why weren't the checks drawn on their own bank accounts?

The Witness: Because Mr. Fribourg was not in town at the time, and I had certain funds belonging to my mother and my wife, and I had access to them; and I got the money together so I could give them one check.

The checks were drawn in two parts for a particular purpose; the $12,500 was drawn in one check and the $2,500 was drawn in a check which was to be held in escrow for all bondholders to participate in that mortgage. A letter sent out to bondholders stated they could, if they wished, participate in that mortgage.

[fol. 131] The $2,500 check was to be held in escrow until such time as they had time to answer.

• • • • • • •

Pages 64-65

Q. By the way, Mr. Becker, were you yourself an officer of Baset Realty Corporation?

A. I don't believe so. I may have been, but I don't believe so.

Q. Will you state what was done, if anything, with respect to affording the other stockholders of the debtor an opportunity to participate in this second mortgage?

A. Mr. Kelly sent out a letter to all of the stockholders and bondholders, calling their attention to the fact that the second mortgage was voted by the stockholders and was going to be placed, and asking them to participate.

Q. Did he ask them to participate or did he offer them participation?

A. He asked them to participate.

Q. He asked them?

A. He asked them to participate.

Q. Did any of them participate?

A. Actually no.

Q. Was any statement made to the stockholders in that communication or otherwise as far as you know as to who it was had advanced the money which constituted the $15,000?

A. I don't know. There must be a copy; Mr. Kelly must have a copy of the letter, there must be somewheres in the records a copy of the letter.

Q. Did Mr. Kelly know that your mother, Mrs. Becker and Mr. Fribourg were advancing the money?

A. Yes.

Q. In what way was that information conveyed to Mr. Kelly?

A. I told him.

Q. When did you tell him?

A. Before it was done.

Q. Was that information conveyed to the board of directors?

A. Yes.

Q. (Continuing) Of the debtor?

A. Yes.

Q. In what way?

A. By telling them.

• • • • • • •

[fol. 132] Pages 68-69

Q. Mr. Becker, I assume you are referring to the minutes of the stockholders' meeting, the annual meeting held on February 17, 1942, and I am directing your attention to one of the later pages to help you. Will you look through those and show me where you informed the meeting of the identity of the persons who were putting up the money?

• • • • • • •

A. Yes, it is covered here by a small paragraph—in this paragraph here (indicating).

Mr. Kahn: What is that; it is in there?

Mr. Hanlon: In response to my question of a moment ago Mr. Becker has indicated to me in the minutes of the annual meeting of stockholders held on February 17, 1942

the following paragraph which I will read for the record (doing so):

"Mr. Amend stated that he had conferred with Mr. Eisenberg and that Mr. Becker would be willing to loan $15,000 on second mortgage provided he be given the right to designate a majority of the board of directors and the right to appoint the managing agent, and Mr. Becker stated that he would increase the offer of the mortgage loan in his letter to $15,000 accordingly."

Q. Is that the statement you indicated?

The Referee: That refers to this Becker, Sanford Becker?

Q. That refers to you, Mr. Becker?

A. Yes. It was in that conversation that I told him.

[fol. 133] Q. I ask you where in the minutes it is shown?

A. That is in reference to that conversation. The minutes refer to a conversation I had with Mr. Amend and Mr. Eisenberg in which conversation I told them who the parties were that were participating in the loan.

Q. My question was directed to the meeting of the stockholders.

A. I stated it at the opening meeting, too.

• • • • • • •

Pages 70-71

The Referee: According to the statement you made at the stockholders' meeting you made it a condition of the loan that you be permitted to have a majority on the board?

The Witness: Yes.

The Referee: Who was the third one?

The Witness: We waived that afterwards; it was changed afterwards so that only two members of the board were designated.

Mr. Kahn: Two members what?

The Witness: Only two members of the board were designated.

The Referee: How many members were there; five?

The Witness: There were at least five.

The Referee: Did you designate also the managing agent?

The Witness: Yes, we did.

The Referee: Who was that?

The Witness: That was the Westchester Trustees.

Q. Is that the full name?

A. Westchester Trustees.

Q. Who are they?

A. They are a co-operative agency which managed a good many of the issues in Westchester County for the courts.

[fol. 134] Q. You have no interest in Westchester Trustees, have you?

A. None whatsoever.

Q. Nor your brother nor Mr. Fribourg?

A. None whatsoever.

* * * * * * *

Page 78

Q. Now, what occurred after the debtor made the assignment of rents to the Baset Realty Corporation with respect to the management of the property, the collection of its income and so on?

A. The mortgagee in possession retained the managing agent to manage the building.

Q. The same agent that managed the property?

A. The same agent.

Q. The one that had been put in when the mortgage was put on?

A. That is correct.

Q. When I say "mortgage" I refer to the Baset mortgage.

A. That is correct.

Q. To whom did the agent make its reports and pay any money which it should have made payment of in connection with the management of the property?

A. They did not make any payment of money because they were not any moneys. They retained the moneys in their managing account.

Q. Did they make reports?

A. Yes, they made reports; one copy to us and one copy to Baset Realty, I believe.

* * * * * * *

Pages 90-91

Q. What offers were received from brokers that you just referred to?

A. A broker came in and said he thought he could get $240,000. I asked him tc submit the offer in writing, and that is the last I heard of it.

• • • • • • •

[fol. 135] Q. How frequently would you say?
A. I should say once a month at least.
Q. You had brokers coming in?
A. Yes.
Q. What was the range of the figures these brokers suggested that they thought they could get?
A. All about the same figure.
Q. In the neighborhood of two hundred and forty thousand?
A. Two hundred thirty, two hundred forty, somewheres in there.
Q. Did any of them go higher?
A. Not that I remember.

• • • • • • •

The Referee: And none of these men ever submitted a written offer?
The Witness: No, sir.

• • • • • • •

Pages 92-93

Q. And you don't remember any offers coming in, except one written offer, the name of which——
A. (Interrupting) I don't remember in whose name it was.
Q. Now, can you tell us the figure, the price?
A. My recollection is it was $250,000.

The Referee: What did you do with the offer?
The Witness: The offer was submitted and rejected.
The Referee: Submitted to whom?
The Witness: The directors.

Q. About when was that?
A. I should say some time in '45.

The Referee: That was at the time during the control of your board of directors?
The Witness: Yes, sir.

• • • • • • •

[fol. 136] Pages 204-205

Q. Let us take up the case of your wife and your mother before we get to Mr. Fribourg, then. When had your wife and your mother seen the building?

A. Early in '42.

Q. Had they ever been inside it?

A. Never.

Q. Had they ever seen any reports or earnings statements or profit and loss statements?

A. No.

Q. Were there any other financial reports in respect to this business?

A. No.

Q. Have they any knowledge whatsoever as to the business of that building?

A. (No answer.)

Q. I say have they any knowledge?

A. Yes. They saw the building from the outside; they saw that it was tenanted, they saw the physical property.

Q. And that you will agree was the sum and substance of their knowledge of the building?

A. Yes. I told them what the first mortgage was and that this would be a second mortgage.

* * * * * * *

Pages 207-208

Q. Have they ever throughout the intervening years acquainted themselves with any of the figures or statements of the company?

A. No, none.

Q. They acted entirely as a result of their conversation with you?

A. The fact that they had a mortgage as security.

Q. I mean, Mr. Becker, they had no other information, except what was derived from you?

A. I don't know what information you mean.

Q. Information as to the business of the building, its financial affairs, its tenancy?

A. None whatsoever.

Q. In April of 1944 there was advanced for taxes due the city of New Rochelle an additional amount of $2,305.09. [fol. 137] That appears also from Mr. Fribourg's testimony that you, rather, your wife and your mother each

advanced one-third of that. Were the circumstances the same?

A. The same.

Q. Were the circumstances the same in connection with the third advance made in October, 1944 of $2,000?

A. Yes.

* * * * * * *

Pages 303-304

Q. Now, with those facts in mind didn't you have some discussion about this letter with Fribourg, Kelly or Winter?

A. I know I did have with Mr. Kelly.

Q. When did you have that discussion with him?

A. We had probably been talking ever since the annual meeting.

Q. What discussion did you have with Mr. Kelly?

A. Mr. Kelly was desirous of withdrawing from the whole picture because of the hopelessness of the situation.

Q. Are you quoting from what he said to you, is this what he said?

A. You asked me in substance. Yes.

Q. Go ahead.

A. Because of the hopelessness of the situation, and he had learned that Mr. Hays, another one of the directors, was anxious to withdraw because as he aptly put it at the time he didn't want to go to the funeral; and they said at the time if they could find some one——

The Referee: Who was this other one?

The Witness: Hays.

Mr. Kahn: Hays.

The Witness: William Henry Hays.

Mr. Kahn: He is a member of the New York Stock Exchange and was a director at the time.

The Witness: Yes.

[fol. 138] A. (Continuing) If we could find some one who would make an offer for the stock they would be glad to get out.

I think I spoke to Fribourg about it and asked him if he was interested in making an offer, and I think as a result of that this offer was made.

Q. What did Fribourg say to the best of your present recollection?

A. I think he said at a price that he would be willing to.

Q. Did you discuss that price with him?

A. No.

Q. Did you discuss it with Kelly or Hays?

A. I think I did after we received the offer or some inkling as to what the offer was going to be.

• • • • • • •

Pages 306-307

Q. I show you this letter which is Objectant's Exhibit 15 and ask you whether you saw that letter before it went out?

A. Yes.

Q. How long before it went out did you see that or a draft of it?

A. Maybe a week.

Q. Did Kelly consult you with respect to the composition of the letter?

A. Yes. As a matter of fact, he asked me for some of the figures.

Q. Did you have any part in the composition of the letter, other than to supply figures?

A. No.

Q. The letter, as I understand it, is composed entirely by Mr. Kelly except that you supplied the figures?

A. Mr. Kelly writes his own letters always.

Q. I am asking you about this letter. Did Mr. Kelly write this letter?

A. One hundred per cent.

Q. Did you make any suggestions about the context of his letter?

A. No.

[fol. 139] Q. At the time Mr. Kelly showed you a draft of his letter did he at the same time show you Mr. Winter's letter?

A. Yes.

Q. Was that the first time you had ever seen Mr. Winter's letter?

A. I think we discussed it before. I think Mr. Kelly composed the Winter offer.

Q. I am asking you when you first saw it. When did you first see what Mr. Kelly composed?

A. He showed it to me.

Q. So your testimony is that Mr. Kelly composed both of these letters?

A. That is correct.

Q. And you had no interest in it, except in supplying the figures?

A. That is right.

* * * * * * *

Pages 310-311

Q. And then beginning in 1933 you began to prepare this report, did you not?

A. As long as the corporation had funds they engaged a public accountant; after they ceased having funds I had to do it.

Q. So that you prepared this in pursuance to the indenture?

A. Yes, I think I did.

Q. It is signed by you?

A. Yes, I did prepare it.

Q. Did you after you became an officer of the company file with the Manufacturers Trust Company any further or other financial report other than the statement of the income and disbursements?

A. We continued to supply the Manufacturers Trust Company with exactly what they had always received.

Q. Which was?

A. A statement of the receipts and disbursements.

* * * * * * *

[fol. 140] EXTRACTS FROM TESTIMONY OF WALTER A. FRIBOURG

Pages 97-98

By Mr. Hanlon:

Q. Were either of the Messrs. Becker connected with you in that business?

A. No.

Q. Neither Norman Becker nor Sanford Becker?

A. No.

Q. Were they connected with you in the textile business?
A. No, sir.
Q. Were they ever connected with you prior to your retirement in any business?
A. No, sir.
Q. Let me put it this way: Did they have any investments in any business that you were interested in?
A. No, sir.
Q. Or hold any securities?
A. No, sir.
Q. Subsequent to the time of your retirement what did you do?
A. I took care of my own investments.
Q. What was the nature of those investments?
A. Mortgages, stocks and bonds.
Q. And where was your office, if any, for that purpose?
A. My home.
Q. In Pelham?
A. That is right.
Q. Do I understand that at no time, neither before nor after your retirement, you had never been connected with the Beckers; and I include in that any reference to the debtor's affairs?
A. No, never—never been in business.

* * * * * * *

Pages 103-105

Q. What were the circumstances under which you went to see the apartments?
A. Mr. Becker told me about it.
Q. Which Mr. Becker?
A. Mr. Sanford Becker.
[fol. 141] Q. What was it he told you?
A. I think that he told me that he had bought a certificate or something on Calton Court or Calton Crescent; and I thought I would go and look at it. That is my recollection. I can't recollect.

* * * * * * *

Q. You were telling us that Mr. Becker, Mr. Sanford Becker, told you that he had bought some certificates or something?
A. That he had some or something.

Q. Or had some?

A. He told me about a building up in New Rochelle.

Q. Did he ask you to do anything in connection with that building?

A. No.

Q. Did he make any suggestion that you yourself should purchase some certificates?

A. No, no.

Q. Am I to understand from your testimony that your purpose in going up at that time to look at the building, to inspect the building from the inside, was because Mr. Becker had told you he had taken an interest in it and you wanted to look at the building then yourself?

A. That is correct.

Q. Having in mind that possibly, if it looked good enough, you would go into it yourself?

A. Possibly.

Q. Do you have now any substantial investments in securities of apartment houses?

A. I don't know what you mean.

Q. You have made it a practice to own apartment house securities?

A. I have had, yes.

Q. During the period that we were speaking about did you own any substantial amount of apartment house securities?

A. Yes.

Q. Was it your practice before you owned these to make an investigation?

A. Yes.

Q. And then if it looked like a desirable investment you would purchase some securities in it?

A. That is it.

[fol. 142] Q. And that is the procedure you followed in connection with the Calton Court?

A. That is right.

And I also have a number of people calling me up to buy things, I mean certificates on real estate and that sort of thing.

Q. You mean to buy them from you?

A. No; to sell them.

Q. To sell them to them?

A. Yes, that is it.

Q. Knowing that you were interested in such things?
A. That I would buy them.
Q. But it was Mr. Becker who told you about this particular property?
A. Yes.
Q. Do you remember when it was that you first purchased any securities of the debtor? By the "debtor" you know I mean the Calton Crescent, Incorporated?
A. Yes.
I think it was in the fall of 1941.
Q. About the time that you went out to look at the property?
A. I think I had looked at the property before, passing there. It may have been around that time.

• • • • • • •

Pages 115-116

Q. So that by January, or, rather, February, 1943 you had purchased $12,000 of the principal amount of debentures and the accompanying stock?
A. That is right.
Q. Do you recollect what were the reasons why you made these additional purchases during that year from '42 to '43?
A. I was buying other things.
Q. No. We are talking about Calton Crescent.
A. Well, I bought it on a speculation.
Q. Did you have any additional information from Mr. Sanford Becker or Mr. Norman Becker?
A. In 1943?
[fol. 143] Q. Leading up to the purchases which by 1943 had aggregated $12,000 in principal amount of debentures?
A. No, I had no special information.
Q. Well, Mr. Fribourg, you had some reason for buying these additional shares or debentures, didn't you?
A. I told you: speculation.
Q. You want us to understand that there was no particular information that came your way from either of the Mr. Beckers?
A. Absolutely not.
Q. Let me ask you this, then, Mr. Fribourg: Isn't it a fact that this speculation, as you call it, was induced by your belief that this was potentially valuable property?
A. I told you, Mr.——

• • • • • • •

A. I told you I thought it was a pretty good proposition because I was predicating it on the fact that four hundred and some odd thousand dollars was the assessed valuation; and somebody told me—I suppose it was Mr. Becker told me—that the taxes were so tremendous on the property and that brought out the assessed valuation; and when I heard that the assessed valuation was four hundred thousand or something like that—and, of course, the natural thing for me to say was, "Didn't they try to have it reduced?"—I don't know what the answer was now, but it wasn't reduced. If it wasn't reduced and it was still $400,000, there must have been some value there.

* * * * * * *

Pages 151-152

Q. To what extent were you familiar with the fact that those offers or inquiries were being made?

A. I was not familiar with it at all.

Q. Is it your testimony, Mr. Fribourg, that at no time did either of the Mrs. Beckers tell you that inquiries or [fol. 144] offers were ever received with respect to this property?

A. Did they tell me?

Q. Yes.

A. No.

Q. You never had any conversation—

A. Well, now, listen here. I won't say that they didn't tell me about it. There may have been times where they said somebody was in on it, but there is still nothing—it is not in my mind that anything was said about the sale of it.

Q. So you have no personal recollection of having been informed on any particular occasion of any prior offer?

A. No, out of that two hundred and fifty thousand.

* * * * * * *

Q. When did you first hear of the contract on the sale of the property which ultimately was consummated, that is, the sale for $300,000?

A. It was some time prior to January 1st.

Q. Of what year?

A. Nineteen forty-six.

* * * * * * *

Pages 153-154

Q. And after that you think the question of your becoming a director did not come up?

A. No, sir; I think I said I did not want to be.

Q. Were you ever requested by either of the Messrs. Becker to become a director?

A. No, sir.

Q. Or an officer?

A. I don't think so.

Q. Was there ever any conversation between you and the Messrs. Becker in which, in words or substance, it was suggested that you not become an officer?

A. No, sir.

Q. With a view to your purchase of securities that it would be better that you not become an officer or director?

A. No.

Q. Did you ever consult counsel, a lawyer, with respect to that matter?

A. No, sir.

* * * * * * *

[fol. 145] Pages 157-160

Q. Now, did you ever have anything to do with operating or managing the Calton Crescent property up in New Rochelle?

A. No, sir.

Q. Did you ever have any contact with the managing agents of that property throughout the years that you owned securities of Calton Crescent?

A. No, sir.

Q. Did you ever go to these managing agents or have them come to you?

A. No, sir.

Q. (Continuing:) And discuss the operating conditions of the property?

A. No, sir.

Q. At the time that you were purchasing these Calton Crescent debentures were you also purchasing stocks or bonds of any other real estate companies?

A. Yes, sir.

Q. (Continuing:) That were for sale?

A. Yes, sir.

Q. And did you buy these other securities through one or many brokers?

A. Numerous—I don't know.

Q. And in connection with these purchases that you made of securities, now, other than Calton, do you recall whether the brokers would call you from time to time to make offers of securities?

A. I didn't get that, sir.

Q. Do you recall whether different brokerage houses would call you on the telephone from time to time and offer you different issues that they had for sale?

A. Well, they would either write or telephone, and if I wasn't there then I may call them back and leave messages.

Q. Did you receive many calls from brokers?

A. Oh, yes.

Q. During these years?

A. Oh, yes.

Q. Offering securities of other issues?

A. That is right.

Q. And did you buy and sell other issues?

A. Oh, yes.

• • • • • • •

[fol. 146] Q. Now, taking up the first purchase that you made of two thousand of certificates through Goldwater & Company, what is your best recollection now as to whether prior to the time that you bought these $2,000 of securities from Goldwater you had ever had any dealings with that firm before?

A. I didn't quite get your question.

Q. What is your best recollection as to——

A. (Interrupting:) That I had done business with them before?

Q. That you had or had not done any business with them before?

A. I don't know. I think I did do business with them before; I think that they—I can't remember; I think they sold me some of that Brooklyn property.

Q. Some bonds?

A. Well, their certificates; they don't call them bonds.

Q. They are brokers of certificated mortgages?

A. That is right.

Q. Is Goldwater & Company what is known as an over-the-counter house?

A. Yes, I think they are an over-the-counter house. They are well known, I think.

Q. And prior to the time that they offered you these bonds of the Calton Crescent they had from time to time called you and offered you other securities, some of which you had bought?

A. I think so.

Q. Let us take Reiley & Company: What is your best recollection as to whether that firm had offered or sold you securities other than Calton Crescent securities prior to August—prior to July of 1942?

A. I can't remember whether they did or didn't, sir; I don't know, I can't remember.

[fol. 147] Q. Do you remember whether you approached Reiley & Company and asked them to pick up such securities for you?

A. I don't think I did; I don't—I can't remember. One of their salesmen may have been with another house or— They are always looking for business.

Q. Now, take the firm of Shaskan & Company. You know, do you not, Mr. Fribourg, that that is a very large and well known stock exchange firm?

A. I know them just as I know all of the rest of them. I don't know their status.

Q. What is your best or present recollection as to whether you had had offers of other securities through Shaskan & Company before you bought this $1,500 security?

A. I may have done business with them because there are quite a few certificates—I never bought unless I knew the property, I wanted to see it; because you don't buy a cat in the bag, you must know the property before you buy it.

Page 178

* * * * * * *

Q. Now, according to your testimony in response to Mr. Kahn's questions, in September of 1943 you were called upon by the Beckers to contribute one-third of the then due taxes amounting to some $3,600. Do you recollect so testifying?

A. That is right.

Q. And your third therefore would have been $1,200?

A. That is right.

Q. Was any statement made to you as to who would contribute the remaining two-thirds?

[fol. 148] A. No, none was made; but I surmised how the other two-thirds would—(interrupted).

Q. There was no discussion about that?

A. No, sir.

Q. Was there ever any discussion with the Messrs. Becker as to the manner in which you may expect to be repaid?

A. Yes.

Q. What representation was made to you?

A. We expected the next time there was any increase, any increase in revenues, I will get it back right away.

Q. Did you inquire of either of these gentlemen as to what the operations of the building were showing?

A. Yes. I knew it was at a loss. But you must get your taxes back right away because then you make somebody else wait and you pay your taxes.

* * * * * * *

Pages 181-182

Q. Was there any inducement made to you for putting up the $1,200?

A. No, I do not think so.

Q. Was any statement made at that time with respect to the offers which had been received on the property or inquiries made from time to time?

A. No, sir.

Q. Mr. Fribourg, do you mean that neither Mr. Sanford Becker nor Mr. Norman Becker told you that the property might well be sold for a substantial amount?

A. No.

Q. And that offers were being received from time to time?

A. No, I knew nothing about offers.

Q. You knew nothing about offers?

A. Nineteen forty-three you are talking about?

[fol. 149] Q. In September, 1943 when you made the first advance for taxes?

A. No.

Q. Was there any statement with respect to the possible sales value of this property made to you at that time to induce you to advance that money?

A. No. What induced me to give the money was the fact that it had to be given, they had to have it; and that the

next month or the month thereafter we would get it back immediately from rentals, and that the tax money was— What do you call it? It had a pre—it had——

Mr. Kahn: A prior lien?

A. (Continuing:) A prior lien on it and you could get your money back because of the prior lien.

Q. That is why you could get your money back?

A. That is what I was told and that is what I knew.

* * * * * * *

[fol. 150] EXTRACTS FROM TESTIMONY OF E. HENRY SONDHEIMER

By Mr. Kahn:

* * * * * * *

Pages 241-242

Q. Mr. Sondheimer, I assume from your testimony here today you have been in this securities business a good many years?

A. Yes, sir.

Q. And dealt in a good many real estate issues?

A. Yes, sir.

Q. And other unlisted securities?

A. Yes, sir.

Q. In addition to having obtained some of Calton Crescent bonds from the individuals whose names you have given here and whom you described as individuals——

A. Yes.

Q. (Continuing:) You purchased, according to the notes I took here, a much greater number of these bonds through Stock Exchange firms and through dealers?

A. Correct, sir.

Q. Can you tell us how or in what manner you had contacts or obtained contacts with these other Stock Exchange firms and dealers?

A. On every deal, sir, there is what is known as the National Quotation Service, of which I am a member—I pay by the year—, which publishes every day what we call the quotation sheets. It is a normal procedure in the business. You have an interest in an issue, you think somebody might buy a certain bond or a certain stock, and you appear in [fol. 151] that quotation service looking for offers; or, if

you have bonds to sell, you are offering securities. And they make up a monthly summary and a semi-annual and an annual summary; and any broker in the normal course of events gets into a situation that he is unfamiliar with. Those are the securities lists.

Q. Did your name and the name of your firm appear on these quotation sheets?

A. Oh, sure.

Q. As being interested in the Calton Crescent bonds?

A. Yes, sir.

Q. Did that bring to you from time to time offers from Stock Exchange firms and other houses that were dealers in them?

A. Definitely, sir.

Q. The letter and the card that you sent out, which you sent out, which have been offered in evidence here, did you submit those before you sent them out to Mr. Fribourg or to anybody else?

A. No.

Q. On these sheets, Mr. Sondheimer, which you mentioned a moment ago, were there any other dealers mentioned from time to time as having any interest in Calton Crescent bonds?

A. Definitely, sir.

Q. You were by no means the only one?

A. No, sir.

Mr. Kahn: I have no further questions.

• • • • • • •

EXTRACTS FROM TESTIMONY OF MYLES B. AMEND

Pages 278-279

By Mr. Kahn:

Q. Now, would it refresh your recollection if I read you this statement:

"At no time in the last several years have the income debentures of Calton Crescent, Incorporated been [fol. 152] selling at more than eight per cent of the face value and the stock has had no market whatever apart from the income debentures."

Do you recall that?

A. I still don't recall it, but I think it was true. I mean I don't recall saying it.

* * * * * * *

Pages 280-282

Q. Is that the fact?

A. I now have no recollection that it is the fact. Apparently I said it then and I must have known at the time that it was a fact. I don't recall today.

* * * * * * *

Q. Now, do you recall making this statement in that affidavit, Mr. Amend (reading):

> "As pointed out in the affidavit of Richard Kelly, sworn to on January 29, 1942, the inability of the defendant (that is, the Calton Crescent) to complete the proposed sale would undoubtedly result in the foreclosure of the first mortgage on its property and the loss of whatever equity may revert to the holders of the debentures and its stock."

A. I don't recall making that statement, no.

Q. In view of the fact that it appears in this affidavit——

A. (Interrupting:) I don't deny it.

Q. May we assume that before making that statement in your affidavit you verified the correctness of it?

A. Surely.

Q. Now independently of the affidavit, Mr. Amend, is it the fact that at that time that you were proposing to accept this offer of the $220,000 the corporation was in arrears on taxes, interest on the first mortgage?

A. That is my recollection, and other creditors.

[fol. 153] Q. And other creditors?

A. And other creditors.

Q. Including obligations to your own firm that had not been paid?

A. I was not thinking of those; I was thinking of operating expenses.

Q. And operating expenses?

A. Yes.

Q. And the plight of the company was certainly serious?

Mr. Hanlon: I object to that question.

(Pending question was read by the reporter.)

The Referee: He may answer.

A. I certainly thought it was then.

Q. Now, did you oppose or did you support, Mr. Amend, as a director the borrowing of this $15,000 from Baset?

A. I think I supported it.

* * * * * * *

Q. Is there any doubt in your mind, Mr. Amend, both as an attorney and also as a former director of this company that the borrowing of this money, $15,000, from Baset by Calton Crescent was a very constructive thing for the Calton Crescent.

* * * * * * *

A. Well, it was certainly a more constructive step than selling the property at the price then offered would have been in the light of subsequent developments.

* * * * * * *

Page 283

Q. Do you recall after some discussions with the King Estate that you reported back to the board that the most that they would loan was $10,000 and that that would not be enough?

A. I don't recall it, but it may very well be.

Q. The fact of the matter is that the $10,000 would not have been enough?

A. I don't recall it, either; but presumably it wasn't or [fol. 154] we would not have been so anxious to get fifteen.

Q. Now, this mortgage which was placed for fifteen, Mr. Amend, and which you handled as legal representative to Calton, was there any bonus of any kind charged for that?

A. I don't recall it, but I don't think so.

* * * * * * *

Extracts From Testimony of Norman S. Becker

Pages 346-348

By Mr. Hanlon:

Q. What records was your brother referring to?

A. To the monthly statements, the same thing. The method of procedure was in 1942 the Westchester Trustees

issued monthly statements showing the cash receipts and disbursements. When the assignment of rents was given in 1943 the statements were issued in the same form, except they were headed up "Baset Realty" instead of "Calton Crescent, Inc.", so that this statement here shows the last three months of the same statement.

Q. So, in other words, there was really only one set of records?

A. There were two sets of records, one for Calton and one was for Baset.

Q. When they speak here of monthly reports that covers all of the records referred to in that paragraph?

A. That is right.

Q. After the Baset Realty loan was made you became a director and officer of the debtor. Did you continue to interest yourself in finding prospective purchasers for the property? I am referring, of course, to the apartment house.

A. At that time, yes.

Q. Did you receive any offers or inquiries from others with respect to the purchase of the property?

[fol. 155] A. I received inquiries asking for figures about the building, but no offers.

Q. Would you be able to estimate the frequency with which those inquiries were received?

A. Well, different brokers would call up and ask for different figures.

Q. What sort of figures?

A. They would want to know what the operating charges were, what the rents were, what the mortgages were, and what was due on conditional bills of sale, and the amount of taxes.

Q. How frequently were those inquiries received, if you can estimate?

A. It is hard to estimate.

Q. With a fair degree of frequency?

A. I would say ever so often and then a broker would hear about it from somebody else and ask for the figures.

Q. He contacted you?

A. He contacted me or Mr. Kelly, or Mr. Kelly asked him to contact me.

Q. These inquiries in one fashion or another were handled by you?

A. Mr. Kelly in most of the times referred them to me.

Q. So that ultimately you handled them?

A. Ultimately I had to give them the figures.

Q. Now, did you get any offers after April, 1942, as distinguished from inquiries?

A. No.

Q. No offers whatever?

A. Not then, no.

Q. From that time on project yourself right to the time that the property was sold. Will you tell me what offers, if any, were received?

A. I think the first semblance of an offer was from a fellow by the name of Rubin.

Q. Do you remember how much that offer was?

A. It purported to be about $250,000, if I remember.

Q. Tell me why are you putting it that way, saying "it purported to be"?

[fol. 156] A. From the type of broker who made the offer. I personally had no confidence in it whatsoever.

Q. Was that offer made on account of—at least purportedly on account of—one Solomon Solomon?

A. I think the name sounds familiar, because I tried to check him up to find out who he was and could not get any information from anybody.

Q. This Rubin was a broker?

A. He was a broker.

Q. And he purported to bring in an offer of $250,000?

A. Yes.

I never met the man, though.

• • • • • • •

Page 350

Q. Was that the inquiry or offer, or whatever it — have been, for $280,000?

A. It was an inquiry; it never crystalized into an offer.

Q. But it was turned down, in any event?

A. The inquiry was turned down. It was made in the form of an inquiry, "Would you take $280,000?".

Q. And the debtor answered no in substance?

A. Yes. I think I was the party that said the stockholders would have to vote on any proposition that would have to be made, so I would not be in a position to tell him any price; it would be a question of submitting a firm offer with a deposit and then submitting it to the stockholders.

Q. Did you say anything to the broker in question about getting a minimum offer of $300,000?

A. I told him that I thought $300,000 should be the price, yes.

• • • • • • •

Page 351

Q. Did you receive another offer over and above, or, rather, as distinguished from the one we have just been talking about of $280,000 or $290,000?

A. No, I don't think so.

[fol. 157] Q. Did you receive an inquiry——

A. No, I don't think so.

• • • • • • •

Pages 354-355

Q. What conversation did you have with Mr. Kelly with respect to this?

A. Mr. Kelly said he prepared a letter of an offer which was to go out and he wanted to prepare an accompanying letter with it because he felt that the time to get out of the Calton as far as he was concerned was the present time, and that he was not interested in selling his stock unless all of the stockholders were offered the same proposition that was being submitted by this letter here; and he said that he personally would be very happy if every stockholder would do it and would get out and would be able to wind up the whole Calton thing and ~~make a~~ finish of it.

Q. Let me ask you this before you go any further with the conversation: Had you heard anything about a proposal to buy the debentures and stock at three per cent of the par value of the bonds?

A. Yes.

Q. Prior to the time that you went down to Mr. Kelly's office?

A. He spoke to me about it when he was up at the annual meeting.

Mr. Kahn: Who spoke to you?

The Witness: Mr. Kelly had spoken to me at the annual meeting and he had seen the yearly ~~figures for '43. He was~~ very disgusted.

Q. What did he say?

A. He said the property never earned a dollar since it was built and it would never earn a dollar until it fell down, and that was his honest conviction, and there had to be a finish to it at some time and now was as good a time as any to finish it.

[fol. 158] Q. When was that discussion, do you recall?

A. In February I think. All of the annual meetings were made then.

• • • • • • •

Pages 356-357

Q. I note from the minutes of the meeting that Mr. Fribourg is listed as having been present at this annual meeting on February 15, 1944. Would it then be your best recollection that you had a talk with him then?

A. I think I had a talk with him then and I think Mr. Kelly had a talk with him then.

Q. Were all three of you talking together?

A. Yes; and I think somebody else was there, I am not sure whether Mr. Hays was there or not or Mr. Clay. I know three or four people were there. Keeler might have been there, too.

Q. At the conversation to which you refer what was said in substance?

A. I mean they were all fairly well disgusted.

Q. I don't want you to say that.

Mr. Hanlon: I move to strike that out, your Honor.

Mr. Kahn: What was said.

Q. (Continuing) What was said? Not how they felt.

A. I don't know how to tell you that then. I mean I could tell you what the gist of it was.

Q. Give me the gist of what was said.

A. The gist of it was that Fribourg said, "I am not going to sell any securities. I gambled with that and I am going to keep them"; and Mr. Kelly and the others who were there said, "If you can find somebody or if you are the only one that wants to gamble, you can have them". That is the gist of it; just the actual words I couldn't tell.

• • • • • • •

[fol. 159] Pages 358-359

Q. Did you go to the Corn Exchange Bank, Grand Central branch, with Mr. Winter in connection with opening an account?

A. I don't even know the manager of the Corn Exchange Grand Central branch bank.

Q. You heard Mr. Winter testify here this afternoon that you went there with him and opened the account and furnished the money?

A. Yes.

Q. Is it your testimony that that event never occurred?

A. Positively not, and positively it was not my money.

The Referee: What?

The Witness: And positively it was not my money.

Q. Regardless of whose money it was, Mr. Becker, did you put the money in, whether it was your money or somebody else's money, as testified to by Mr. Winter?

A. No, I didn't.

Q. You never went with Mr. Winter to that bank?

A. No.

The Referee: And you say the money that went into that account was not your money?

The Witness: Absolutely not.

Q. Do you know whose money it was?

A. It was Fribourg's bank, so I imagine it was from Fribourg.

• • • • • • •

Page 360

Q. We were talking a while back about a conversation with Mr. Kelly at his office at 233 Broadway on the day he showed you the draft of the Winter letter, Objectant's Exhibit 14. Will you go on with that conversation? You [fol. 160] started to tell me what happened and I interrupted you to go back——

A. Well, I mean I can tell you what the gist of it is.

Q. That is all I want.

A. As I remember, the gist of the conversation was he thought it was a good idea to make the offer as he wanted all of the securityholders to have it. He did not want to sell unless the same offer was made to every securityholder;

he even went farther and said, "If Winter wants to buy, we have no money. Winter will have to pay to have these letters mimeographed and sent out". But I thought it would be perfectly proper*ly* that we send the letters out for him.

The Referee: Who is this; Kelly?

The Witness: Yes.

• • • • • • •

Page 365

Q. So there will be no misunderstanding about my question, did you, outside of that one instance, use the records of the company—whether it is the stock records or other records—to circularize the stockholders or permit other people to circularize them with respect to the sale of securities?

A. No.

• • • • • • •

Pages 366-369

Q. In your affidavit which you verified on June 8, 1946 in this particular proceeding—this affidavit was made in opposition to motions by the Manufacturers Trust Company and the Securities and Exchange Commission—you said (reading):

> "I should further call to the Court's attention that the annual reports were mailed to the stockholders from [fol. 161] time to time up to and including the year 1945, apprising them of the sound position of the debtor's finances."

What was the form of these annual reports?

A. Usually the president's report or a copy of the report that was sent to the Manufacturers Trust Company each year.

Q. Do you have any of those reports in court with you?

A. No, no. I think they are in the minute book. What was sent out is usually in the minute book.

Q. Will you show me the last one which was sent out? We will start with that.

A. Well, I see here in February, if you want me to read from this here (indicating).

Q. Just show it to me. February of what year is this?
A. This seems to be February of 1944, which was sent out.
Q. You are indicating a letter?
A. Which Mr. Kelly sent, yes, in which he described the condition of the company; and I imagine that was the last one then from what it says here.
Q. May I just see that, please, Mr. Becker?
A. I imagine so; I don't know.

Mr. Hanlon: The witness has indicated a communication dated January 26, 1944 addressed to the stockholders of the debtor, signed by himself as secretary, to which is appended a long communication signed by Mr. Kelly as president.
The Witness: Yes.

Q. I understand, Mr. Becker, as far as you know this was the last report that was sent to the stockholders?
A. I mean without going through more carefully it seems to be.

[fol. 162] The Referee: What is the date?
Mr. Hanlon: That is January, 1944.
The Witness: January 26, 1944.
Mr. Hanlon: May I ask, your Honor, whether Mr. Kahn has any later report?
Mr. Kahn: I don't know.
(Further informal discussion ensued.)

Q. Subject to correction if you find out otherwise, Mr. Becker, then may we take it that this report dated January 26, 1944, this communication, is the last sent to the stockholders in the nature of a report?
A. I mean from the language of this here it seems to be from what Kelly says here, it seems that there weren't any sent out after that.

Mr. Hanlon: Then subject to correction—because the witness is doing the best he can—I offer this in evidence. The witness has stated that as far as he knows that is the last communication in the way of a report,
The Witness: That is January 26, 1944.
The Referee: All right.

(The same is received in evidence and marked "Objectant's Exhibit 29" of this date.)

Q. Now, in the first paragraph of Mr. Kelly's part of this communication he says (reading):

> "Your personal attendance is urged, especially since the company has no funds available to forward and send to stockholders the earnings statement and balance sheet as has been done in previous years."

[fol. 163] Do you have any of the earnings statements and balance sheets to which Mr. Kelly refers as having been sent to stockholders in the previous years?

A. They should be in the book here.

Q. Will you look, for example, and find the one that would have been sent out in 1943?

A. I think this should be the one (indicating); yes, this looks like a mimeographed affair; it is a report and that is the statement of income and that is the balance sheet. I think this should be the one.

Q. Is this which you are indicating to me the form of reports which were sent out prior to 1944?

A. I imagine so—I imagine so.

Mr. Hanlon: I will offer that in evidence.

The Referee: What is it; the one for '43?

Mr. Hanlon: That was the report sent in 1943 to the stockholders covering the '42 figures.

Mr. Kahn: I have no objection.

Mr. Hanlon: Please mark them as one exhibit.

(The same are received in evidence and marked, "Objectant's Exhibit 30(3)" of this date.)

• • • • • • •

Pages 375-376

By Mr. Kahn:

Q. And did you talk to him when the management of that company was turned over to this servicing organization known as the Westchester Trustees?

A. That is right.

Q. When did that happen?

A. That happened in April, 1942.

Q. That was still before your connection with the company?

A. That is right. The loan had been approved and the [fol. 164] management had been changed, and that was

changed by the former directors and officers before we became officers and directors.

Q. Now, the Westchester Trustees, can you tell us something about them; who were they?

A. They were a servicing outfit in White Plains, who had been taking care of properties for the court and the rehabilitation of all the certificated properties in Westchester, and they had a very good standing in Westchester, very reliable; and Mr. Amend ~~and~~ Mr. Kelly knew ~~some of~~ the trustees, and they were very much inclined to give them the management of the property because they thought it would be in good hands.

Q. And they proceeded to do so?

A. They did.

Q. Now, they remained in control of the property until the Baset mortgage was put on?

A. That is correct.

Q. After the Baset mortgage was put on were they still permitted to maintain the same management?

A. That happened simultaneously.

Q. There was no change made because the Baset mortgage went on?

A. No.

* * * * * * *

Page 377

Q. Was the compensation charged by the Westchester Trustees less than Mr. Keeler had been charging?

A. Yes.

Q. Substantially?

A. I think all of their management charge was $120 a month for taking care of the property.

Q. They attended to the renting, did they?

A. They attended to the renting.

Q. And to hiring the help?

A. Hiring the help.

Q. And making all repairs?

A. And making all repairs and stalling off all of the creditors. Their reputation carried them along.

* * * * * * *

[fol. 165] Pages 378-380

Q. As I understand the situation, you made no change in the picture after the rent assignment was given to the Baset?

A. There was no change made at all. There was only a change made in the name of their bank account at the County Trust Company in White Plains from the Calton Crescent to the Baset Realty; that was the only change made.

Q. When they paid out moneys by way of expenses in the operation of the property they made these payments through their own checks?

A. No; they sent the checks down to New York and Mr. Kelly signed the checks jointly with myself I believe or my brother. There were two signatures required on every check.

Q. But they would draw them?

A. They drew every check and sent the vouchers down with the original bills. That is how I happened to see Mr. Kelly so often.

The Referee: You or Kelly signed?

The Witness: Jointly. There were two signatures necessary.

Q. You say you went up to this property twice a week?

A. That is right.

Q. From the time that the Westchester Trustees were employed?

A. That is right.

Q. And were you satisfied that they were doing an efficient and competent job?

A. They were doing a very good job.

Q. Better than Keeler had done?

A. Absolutely.

Q. In addition to sending these annual reports to the Manufacturers Trust Company, Mr. Becker, do you recall whether or not in the year 1945 there was any talk that you had with Mr. Gage, the vice-president of that bank, [fol. 166] about having the Trust Company make a personal inspection of the property?

A. I believe it was in '44.

Q. Forty-four?

A. That he wanted to make an inspection of the property

Or, it might have been right up to the rent assignment; I am not sure.

Q. What was the talk you had with him about?

A. He asked me if I would send them a letter so that their representative, a party by the name of Reider or Reidell— I have just forgotten the name—, he wanted to send them up to look at the property to be satisfied that everything was all right; and he said he had a friend or knew of a broker in New Rochelle that he wanted us to co-operate with and furnish all particulars, that this broker thought that he might be able to sell this property.

Q. What did you do about that request?

A. I instructed the representative myself to go there, and he did go there and he made an inspection of the entire property; and the broker called me up a number of times and I gave him full information with the number of leases and the dates of the expirations and the expenses—something which we did not want to give to anybody because they were, perhaps, higher than they should have been—, but we co-operated fully in giving him all of the information that they requested.

Q. Did this broker ever produce an offer?

A. Never.

* * * * * * *

Pages 381-385

Q. Mr. Becker, did you have anything to do with the acquisition of this block of bonds—I think it was $37,500— from Reynolds, Richards & McCutcheon, counsel for the King Estate?

A. Yes.

Q. Will you tell us what your participation was?

A. I had innumerable talks with Mr. Minor.

[fol. 167] Q. Mr. Minor, who is he? You have not identified him.

A. Minor is one of the partners of Reynolds, Richards & McCutcheon.

Q. That is a very large law firm, is it not, in New York?

A. Yes, I believe it is.

Q. Established for a long time in New York?

A. Yes.

Q. These counsel had been the counsel for the King Estate?

A. That is right.

Q. And the King Estate was one of the largest holders?

A. The largest individual holder.

Q. Was there any approach made by either Mr. Minor or Mr. McCutcheon to you with regard to a sale of the holdings of the King Estate?

A. Oh, I believe it was in the end of '43 or the beginning of '44 when one of the trustees of the King Estate, which Mr. Kelly had represented, had died or was interned in France, as Mr. Kelly told me about it; and when they appointed a trustee for the King Estate it was at that time that they decided that they would like to sell their bonds.

The Referee: Did they approach you in the first instance?

The Witness: Yes, they did.

The Referee: Or did you approach them?

The Witness: No; they approached me.

Q. You are positive of that?

A. Positive.

Q. Who was it first approached you?

A. Mr. Minor.

Q. Had Mr. Minor any familiarity with the affairs of the Calton Crescent at the time of this original approach to you?

A. Yes, he did.

The Referee: You say he had been at stockholders' meetings?

[fol. 168] The Witness: Yes.

The Referee: With a proxy?

The Witness: Yes, because they never gave anybody else a proxy except Mr. Minor.

In addition to that about every three months he used to write or call and ask me if I would not please send him the operating statements or a recap of the operating statements for the first three months of 1943 or the last six months of 1943, or something like that. So he got the figures continually as he requested them.

Q. Let's come back to this initial discussion that he had with you. Tell us about when that was and also what was said by you and by him.

A. I imagine it was in the spring.

The Referee: What?

The Witness: I imagine it was in the spring of '44 when he told me that the trustees had decided that they would like to sell their bonds, that they didn't feel there was any more hope to the situation, and asked if I knew of anybody who wanted to buy the bonds. So I told him I didn't know off-hand, but I would approach some of the other stockholders if he wanted me to and find out.

But it was also a question of what he wanted for his bonds. So he said, well, in 1942 they had an idea that if the original sale at $230,000 had gone through the bonds might have paid between eight and ten, but if they got ten now they would be very happy to get it, and if I could get them a purchaser at the rate of ten they would do it.

So, as I recall it, I told them if they would please take it up with Mr. King first and send me a letter authorizing [fol. 169] me to offer those bonds at that price, good for thirty days, that I would do it; and he did.

* * * * * * *

Q. With whom did you take up the matter of purchasing these bonds?

A. Well, I took it up with Mr. Fribourg and I took it up——

The Referee: With who?

The Witness: With Fribourg.

A. (Continuing) And I took it up with my mother who had had some bonds there and with my sister-in-law; and I told her that I would not buy them myself, but that these bonds were offered at ten, if she wanted to take a gamble I thought it was up to her; and she said she would speak to Sanford about it, and she subsequently bought them.

Q. I assume Sanford finally talked to you about the matter, didn't he?

A. Yes, he spoke to me about it.

Pages 386-387

Q. After your brother had indicated that his wife and your mother would accept this offer of ten, who communicated that fact to Mr. Minor?

A. I did, I spoke to him.

Q. Yes?

A. And I told him when he got the bonds ready he should call me, and he said he would let me know or drop me a few lines and let me know; but that the one thing they wanted was the bank treasurer's check—it did not necessarily have to be certified; they preferred to have a bank check for these things—, and they would have them all fixed up and he would let me know in due time.

[fol. 170] Q. Do you know whether a payment was made in that fashion?

A. That is correct.

Q. Through a bank check?

A. That is right. I personally delivered it.

Q. And then the bank on receipt of the check delivered the bonds?

A. That is right.

• • • • • • •

Pages 389-398

Q. Mr. Becker, when you were last on the stand I was interrogating you about the negotiations with Mr. Minor of Reynolds, Richards & McCutcheon. Before he made the offer to sell the bonds of the King Estate, Mr. Becker, had you met him at various meetings of the debtor corporation?

A. My recollection is that he was present, that he attended every annual stockholders' meeting.

Q. And in between these stockholders' meetings do you recall many occasions when he requested information concerning the rental condition of the property and the expenses of the property?

A. About every second month he either called or communicated in writing with me and asked for the position of the company as far as indebtedness and gross receipts and the general operating conditions.

Q. And did you furnish him that information?

A. In each and every case.

Q. Now, did that situation continue up to the time that he made this proposal to sell the block of bonds owned by the King Estate?

A. Yes, it did.

Q. Now, there was another block of bonds purchased by the Y.W.C.A., the Young Women's Christian Association.

Have you any familiarity at all with the negotiation that resulted in that purchase?

A. Yes, I do.

Q. Did you have anything to do with it?

A. I did.

[fol. 171] Q. With whom did you conduct that negotiation?

A. With Mr. Clay who was a director of the company.

Q. What connection did he have with the Young Women's Christian Association?

A. He was on the committee, on the investment committee of the Y.W.C.A.; he handled most of their real estate.

Q. Did he attend many or practically all of the stockholders' meetings of the debtor?

A. Practically all while he was well. There was one period of time there while he was ill, but outside of that he even when he was ill requested copies of minutes and he was furnished them.

Q. Now, do you recall the first approach that was made in connection with the sale of this block of bonds owned by the Young Women's Christian Association?

A. My nearest recollection is that he called me on the 'phone and he said that they had decided to sell their bonds, that if I would be able to find a purchaser for them that they would like to sell very much; and he felt that they should get ten per cent for them and he said, "Take as much time as you want. When you find somebody that will pay ten for them, call me and we will arrange to sell them."

Q. Was that after the purchase had been made from the King Estate?

A. It was about the same time; I don't know whether it was before or after.

• • • • • • •

Q. Do you recall now, Mr. Becker, whether in his discussions with you Mr. Clay made any reference to the sale by the King Estate?

A. Well, he knew that the King Estate had either sold or had wanted to sell.

The Referee: How do you know he did?

The Witness: Because he had told me at the time.

[fol. 172] Q. What did he tell you?

A. He told me that he heard the King Estate had either sold their bonds or proposed to sell their bonds, and that was one of the reasons that they wanted to get out also.

Q. What did you tell him when he told you they would sell their bonds if you could find somebody to pay ten?

A. I told him at the minute I do not know anybody.

Q. What happened after that?

A. I spoke to two or three people about them and nobody wanted to buy them, and I spoke to my sister-in-law and she said she would buy them; and I called Mr. Clay and I told him I had found a purchaser for them and when he would arrange to deliver those bonds let me know and I would endeavor to get a bank draft for it, which was done.

Q. I show you a copy of a letter addressed by Mrs. William Henry Hays, the secretary of the investment committee of the Young Women's Christian Association; addressed to Mr. Williamson, the assistant trust officer of the Fifth Avenue Bank, dated February 5, 1945, and *and* ask you whether that copy of letter was sent to you in connection with the sale of these bonds owned by the Y.W.C.A.?

A. Yes, it was.

Mr. Kahn: I offer that in evidence.

Mr. Hanlon: May I just look at it?

Mr. Kahn: Yes, certainly (handing same to counsel).

Mr. Hanlon: No objection.

(The same is received in evidence and marked, "Respondents' Exhibit 4" of this date.)

Q. I also show you a certified copy of a resolution of the Young Women's Christian Association, adopted February 5, 1945, authorizing the sale of these $7,550 face amount of debenture bonds, and ask you whether that was sent to you by either Mr. Clay or Mrs. Hays?

A. Yes it was. The signature is even guaranteed by [fol. 173] the Fifth Avenue Bank.

Mr. Kahn: Yes.

I offer that in evidence (handing document to Mr. Hanlon).

Mr. Hanlon: No objection.

(The same is received in evidence and marked, "Respondents' Exhibit 5" of this date.)

Q. Mr. Becker, do you happen to know whether Mrs. Hays, the secretary of the Young Women's Christian Association, is the wife of the Mr. Hays who was a director of the Calton Crescent?

A. Yes, she was.

Q. And was Mrs. Hays also a former director of the Calton Crescent?

A. I believe she was.

Q. Mr. Becker, a moment ago I was interrogating you about communications you had with Mr. Minor of Reynolds, Richards & McCutcheon before this sale of the bonds of the King Estate was made. I now show you a series of letters, some from Reynolds, Richards & McCutcheon and others from you to Reynolds, Richards & McCutcheon, and ask you to look at these, please, and tell me whether those letters were actually sent or received?

A. Yes, these all were.

Mr. Kahn: I offer those in evidence.

Mr. Hanlon: Do you offer them separately?

Mr. Kahn: Yes, I offer them separately.

Mr. Hanlon: Were those pencil marks—(interrupted by).

Mr. Kahn: I will not offer those. I don't know what they are, but I will disregard them.

Mr. Hanlon: No objection (further colloquy following).

The Referee: What do they purport to show?

[fol. 174] Mr. Kahn: They show, your Honor, that Mr. Minor was constantly asking about figures and information about the property, and these are the answers giving him the data.

The Referee: Minor was——(interrupted by.)

Mr. Kahn: (Interposing) A member of the firm of Reynolds, Richards & McCutcheon, the counsel for the King Estate.

I am arranging these in date order. I offer first in evidence the letter addressed by the secretary of Calton Crescent, Inc. to Mr. Kelly, Mr. Hays, Mr. Clay and Reynolds, Richards & McCutcheon, dated July 30, 1943.

(The same is received in evidence and marked, "Respondents' Exhibit 6" of this date.)

Mr. Kahn: I next offer in evidence a letter from the secretary of Calton Crescent, Inc. to Reynolds, Richards & McCutcheon, dated August 4, 1943.

(The same is received in evidence and marked "Respondents' Exhibit 7" of this date.)

Mr. Kahn: I next offer in evidence a letter from the secretary of Calton Crescent, Inc. tc Reynolds, Richards & McCutcheon, dated August 23, 1944.

(The same is received in evidence and marked "Respondents' Exhibit 8" of this date.)

Mr. Kahn: I next offer in evidence—these are out of order because I got confused on the year—a letter from Reynolds, Richards & McCutcheon to Calton Crescent, dated September 24, 1943.

(The same is received in evidence and marked, "Respondents' Exhibit 9" of this date.)

Mr. Kahn: I next offer in evidence the reply to that letter dated September 27, 1943, addressed by the secretary of Calton Crescent, Inc. to Reynolds, Richards & McCutcheon.

[fol. 175] (The same is received in evidence and marked, "Respondents' Exhibit 10" of this date.)

Q. Mr. Becker, are you familiar with the purchase of some Calton Crescent bonds by Mr. Fribourg from William Henry Hays?

A. Yes, I remember something about it.

Q. What do you know about it, if anything?

A. William Henry Hays was a former director and stockholder and when he sold his bonds he asked me if I would not talk to Fribourg, that he thought he wa*h* entitled to a quarter or half a cent more than anybody else got for their bonds. I told him I didn't know. But when I talked to Fribourg, Fribourg said if he felt that way he would pay it to him; and when he sold his bonds he received something more than the other people did.

• • • • • • •

Q. Mr. Hays you say was a director of the company?

A. That is right.

Q. How long had he been a director?

A. Since the company was located—since the company was formed.

Q. Do you know if he held a membership on the New York Stock Exchange?

A. Yes, he did; he still does.

Q. Before he made this sale to Fribourg did you have any correspondence with him relating to the affairs of Calton Crescent?

A. I think about the time that the assignment of rents was given I had written to him about the condition of the company, yes.

Q. I now show you a letter addressed to you by Mr. Hays, dated August 2, 1943, and ask you if you received that letter?

A. Yes—yes, that is right.

Mr. Kahn: I would like to offer that in evidence.

Mr. Hanlon: No objection.

(The same is received in evidence and marked, "Respondents' Exhibit 11" of this date.)

[fol. 176] Q. Do you know, Mr. Becker, how long Mr. Hays continued to remain on the board of directors of the debtor?

A. He remained until he sold his stock and then he resigned.

Q. Do you recall when that was?

A. I think it was in the summer of '44, if I am not mistaken; either the spring or the summer.

Q. Did you meet him with any frequency at all?

A. I had seen him on and off at times, yes, sure.

Q. And did he ever ask you for information concerning the affairs of Calton Crescent aside from what was revealed at the stockholders' and board of directors' meetings?

A. Definitely yes, because he used to sign checks and stockholders' certificates, even before the assignment of the rents he used to sign stock certificates and I had to take them down there to have them countersigned by him.

Q. When you went down there for that purpose did you have frequent discussions with him about Calton Crescent?

A. Yes. He knew about the affairs of the company all the time until he resigned as a director.

Q. What makes you say he knew about these things?

A. Because he had seen copies of the monthly statements each month and he knew exactly about the condition.

Mr. Hanlon: I object to that.

Mr. Kahn: I consent to that.

Q. The monthly operations of the company——

A. (Interposing) Were furnished to him.

Q. (Continuing) Were furnished to him?
A. Yes, he saw them each and every month.
Q. Did he come regularly to the directors' meetings?
A. Yes, always.
Q. And were the affairs of this company discussed at these meetings?
A. Yes, very much so.

• • • • • • •

[fol. 177] Page 403

Q. Now, Mr. Becker, the amount mentioned in this last exhibit as owing on these operating bills was \$3,365.79. Does that refresh your recollection as to the amount?
A. Yes, I saw it in the papers just now.
Q. Where did you get the list of these bills?
A. The Westchester Trustees had been operating the property and they sent down a list of the bills that were owing at that time with which they hadn't any money to pay.
Q. What was done about paying these bills?
A. Well, the Baset Realty put up the money and paid the bills so that all of the creditors were appeased.

• • • • • • •

EXTRACTS FROM TESTIMONY OF STERLING B. JORDAN

Page 448

By Mr. Kahn:

Q. Even with those savings on the fuel and the elimination of the bus the property still continued to operate at a deficit?
A. It did.

The Referee: Until 1945?
The Witness: Yes.

• • • • • • •

Q. Now, during all of this period that you were in charge of the property, Mr. Jordan, did you confer with real estate brokers from time to time with regard to the sale of the property?
A. I did.
Q. Can you tell us approximately how many different brokers came to see you with regard to effecting a sale of this property?

A. There must have been a dozen.

Q. Did these brokers come and ask for information from you?

A. That is right.

[fol. 178] Page 449

Q. Concerning the rentals, the dimensions and the condition of the property?

A. That is right.

Q. Did you give the information that these brokers wanted?

A. I did.

Q. To all of them?

A. Yes, to all of them.

Q. Did you ask these brokers to submit any offer to you, if they had one?

A. I did.

Q. Did you at any time during the three years or more that you were in there as manager ever get an offer for any of that property from any of these brokers?

A. No, not one.

Q. Not a single one?

A. No.

Q. Did you tell these brokers if they had any offers that you would submit them to the owners?

A. I did.

• • • • • • •

Page 463

By Mr. Hanlon:

Q. Just what do you mean by that?

A. Well, we had people coming in and saying they were going to make an offer. When I say "a firm offer" that would be an offer accompanied by a check that would make it a real offer.

• • • • • • •

Page 469

Q. Wasn't there a belief in your organization that the situation steadily would improve in view of all conditions? My question is directed to '42.

A. Well, we were very pessimistic at that time; that is my recollection.

Q. When did that pessimism cease?

A. Because we were giving at that time concessions. We were giving concessions even in 1943.

* * * * * * *

[fol. 179] Excerpt From Respondents' Exhibit 1 for Identification

Affidavit of Myles B. Amend, Verified January 29, 1942

* * * At no time in the last several years have the income debentures of Calton Crescent, Inc. been selling at more than eight (8%) percent of the face value and the stock has had no market whatever apart from the income debentures. * * *

As pointed out in the affidavit of Richard Kelly, sworn to January 29, 1942, the inability of the corporate defendant to complete the proposed sale will undoubtedly result in the foreclosure of the First Mortgage on its property and the loss of whatever equity may be left to the holders of its income debentures and stock.

* * * * * * *

[fol. 180] RESPONDENTS' EXHIBIT 3

Calton Crescent, Inc.

Operating statement for year ending December 31, 1944

Income		$61,333.50
Disbursements		
Taxes on Real Estate	$14,020.36	
Interest on 1st Mortgage	7,197.55	
Amortization on 1st Mortgage	3,500.00	
Insurance	1,965.67	
Fuel	4,932.68	
Payroll for building help	7,818.74	
Gas & Electric	2,302.87	
Water	1,456.87	
Mechanical Refrig. payments	1,121.00	
Elevator mainten--ce	624.00	
Franchise Tax	119.06	
N. Y. State Unemployment Insurance	206.80	
Federal Old Age Ins.	76.69	
Renting Commission paid brokers	449.73	
Advertising	53.27	
Telephone	152.41	
Management fees	2,397.60	
Decorating	5,721.08	
Exterminating	69.00	
Garbage Removal	165.00	
Supplies	1,766.91	
Shades & Awnings	337.55	
Window Screens	330.00	
Repairs, Grounds, Landscaping	1,226.06	
Repairs to building	4,478.81	
Repairs, Plumbing, Refrig. etc.	477.47	
Miscel. expenses	169.96	$63,137.14

[fol. 181] EXCERPT FROM RESPONDENTS' EXHIBIT 4

February 5, 1945.

Mr. G. S. Williamson, Assistant Trust Officer, The Fifth Avenue Bank of New York, 530 Fifth Avenue, New York 19, N. Y.

DEAR MR. WILLIAMSON:

You are hereby authorized to sell to Norman S. Becker, 11 West 42nd Street, New York, N. Y. for account of the Board of Trustees of The Y.W.C.A. of the City of New York, securities as follows:

151 shares common capital stock of Calton Crescent, Inc.

$7,550. income debenture bonds of Calton Crescent, Inc. maturing September 27, 1953.

Transfer of the above securities to Mr. Becker is to be made upon receipt of payment of $750. net to The Y.W.C.A. of the City of New York.

• • • • • • •

The proceeds of the above sale are to be credited to the Board of Trustees' Account.

Please send reports of the above sale to the Business Manager-Comptroller of The Y.W.C.A. of the City of New York, 129 East 52nd Street, New York, N. Y.

By authority of the Investment Committee of the Board of Trustees of The Y.W.C.A. of the City of New York.

Yours very truly, Mrs. William Henry Hays, Secretary, Investment Committee.

[fol. 182] RESPONDENTS' EXHIBIT 6

(Letterhead of)

Calton Crescent, Inc.
11 West 42nd Street
New York

July 30th, 1943.

DEAR SIR:

The Poughkeepsie Savings Bank holders of the first mortgage on our property have served notice of their intention to foreclose the mortgage because of our failure to pay the 3rd quarter of the real estate tax to the City of New Rochelle, due July 1st, the last day for payment of said tax is July 31st 1943.

We will have no funds on hand with which to pay these taxes. The 2nd quarter tax which was due on April 1st was paid last week, namely July 20th 1943.

We will therefore be faced with the following payments in the next 30 days:

$3,585.00—3rd quarter tax due July 1st 1943.
2,700.00—Interest and Amortization due Aug. 1, 1943.
4,000.00—Current bills owing creditors.

$10,285.00

Our collections are about $4,600.00 monthly, and even if we apply the next 3 months collections to the payment of the above current obligations, we would be in no better position to pay the next installment of taxes and interest and amortization.

Mr. Kelly is familiar with the situation and at his suggestion, I am informing all of the officers and directors of our financial condition, as it is one of utmost seriousness.

[fol. 183] I would like an expression of opinion from all the officers and directors, and await your early advices as to what steps can be taken to overcome the above mentioned deficiencies and forestall foreclosure.

Very truly yours, Calton Crescent Inc., —— ——, Secretary.

Copies sent to: Mr. Richard Kelly, Mr. Wm. Henry Hays, Mr. Arvah E. Clay, Messrs. Reynolds Richards & McCutcheon.

[fol. 184] RESPONDENTS' EXHIBIT 7

August 4, 1943.

Reynolds, Richards & McCutcheon, 68 William Street, New York City.

DEAR SIRS:

In accordance with the request contained in your favor of the 3rd, we are itemizing disbursements from the monthly statement:

Taxes	3,671.45	Repairs	2,581.19
Interest	4,067.61	Labor	3,464.35
Amtz.	1,750.	Elevator Man.	260.
Water	670.04	Painting, supplies and all sundry expense	4,885.60
Insurance	1,011.34		
Legal fees	236.25		
Directors fees	100.		
Officers Salary	600.		$11,191.14
Unemployment Social Security	272.02		
Boiler Conv.	679.		
Management	770.40		
Gas & Electric	1,242.81		
Fuel	1,665.34		
Refrig. payment	1,032.60		
	$17,768.86		

Very truly yours, —— ——, Calton Crescent, Inc., Secy.

[fol. 185]

RESPONDENTS' EXHIBIT 8

August 23, 1944.

Reynolds Richards & McCutcheon, 68 William Street, New York City, N. Y.

Attention Mr. R. Minor

DEAR SIRS:

In accordance with your request we are listing the results of operations for the period January 1st to July 31st;

	Income	Disbursements
January	$4,675.50	5,571.83
February	5,055.50	4,629.97
March	5,160.50	5,737.89
April	4,999.00	5,145.10
May	4,757.00	4,356.44
June	5,168.00	4,107.60
July	5,418.00	6,480.19
	$35,233.50	$36,029.02

As of July 31st 1944 there was due on mortgages,

1st Mortgage	$159,250.—
2nd Mortgage	20,921.63 with interest
Operating bills	6,575.— payable

Trusting that this is the information that you desire,

Very truly yours, —— ——, Calton Crescent Inc., Secy.

[fol. 186] RESPONDENTS' EXHIBIT 9

(Letterhead of)

Reynolds, Richards & McCutcheon
Attorneys and Counselors at Law
68 William Street
New York 5, N. Y.

September 24, 1943.

Calton Crescent, Inc., 11 West 42nd Street, New York, N. Y.

Attention of Mr. Norman S. Becker, Secretary

DEAR MR. BECKER:

At your convenience would you please let us have the following information:

(1) The present principal amount of the first mortgage held by the Poughkeepsie Savings Bank.

(2) The present principal amount of the second mortgage plus the amount of arrears on the first mortgage paid by the second mortgagee.

Very truly yours, Reynolds Richards & McCutcheon.

[fol. 187] RESPONDENTS' EXHIBIT 10

September 27, 1943.

Reynolds, Richards & McCutcheon, 68 William Street, New York City, N. Y.

DEAR SIRS:

In reply to your favor of the 24th instant, please be advised that the present amount due on the first mortgage is \$161,875.—. The amount due on the 2nd mortgage is \$15,000.— plus \$3,804.04 advanced by the holder of the 2nd mortgage. The amount of bills outstanding and unpaid is about \$4,000.—.

Trusting that this is the information that you desire, we are,

Very truly yours, —— ——, Calton Crescent Inc., Secy.

[fol. 188] RESPONDENTS' EXHIBIT 11

BOwling Green 9-7027

William Henry Hays
Member of the New York Stock Exchange
71 Broadway
New York

August 2, 1943.

Mr. Norman S. Becker, 11 West 42nd Street, New York, N. Y.

Re: Calton Crescent, Inc.

DEAR SIR:

Your letter of July 30th reached me this morning. Needless to say I am not at all surprised at the financial condition of the company. I have struggled with this situation for more than ten years and for a long while have realized that it is hopeless. I can see no way out of the situation because no one would lend us the money to pay interest and taxes, and we would only be getting in deeper through further borrowing. I think that we shall have to officiate at the last rites.

Mr. Kelly also wrote me similarly and enclosed a draft of the minutes of the Directors meeting held March 27, 1943, asking me as well as other directors to notify you if we had any corrections or additions. The minutes as drafted by Mr. Kelly appear to me to be correct though it is of course impossible for a busy man to have accurate recollection of what transpired at a Directors meeting held over four months ago.

Very truly yours, Wm. Henry Hays.

WHH:B.

[fol. 189] RESPONDENTS' EXHIBIT 15

Dollar Savings Bank
of the City of New York
Third Avenue at 147th Street
New York 55, N. Y.

Wm. B. Westerfield, Assistant Treasurer.

September 18, 1944.

Carlton Crescent, Inc., c/o Mr. Norman Becker, Secretary, 11 West 42nd Street, New York 18, N. Y.

Re: 43 Carlton Road, New Rochelle, N. Y.

DEAR SIR:

In connection with your application for a first mortgage loan covering the above premises, we regret to advise you that we are not interested in this application because of the amount requested.

We thank you for your inquiry, however, and perhaps we may be of service to you at some future date.

Very truly yours, Wm. B. Westerfield, Assistant Treasurer.

WBW:rw.

[fol. 190] RESPONDENTS' EXHIBIT 16

SUPREME COURT, NEW YORK COUNTY

SANFORD BECKER, ET AL., PLAINTIFFS

against

RICHARD KELLY, ET AL., DEFENDANTS

STATE OF NEW YORK,
County of New York, ss:

William Henry Hays, being duly sworn, deposes and says that he is one of the above named defendants and is the Vice-President and a Director of the defendant Calton Crescent, Inc.

That he has read the foregoing affidavit of Richard Kelly, sworn to the 29th day of January, 1942, and that

the statements in said affidavit are all correct to the best of deponent's knowledge, information and belief.

Deponent particularly states that he received full detailed reports monthly from Keeler Real Estate Corporation, of its management of the property—Calton Court Apartments, and diligently examined the same and conferred as to the same with Keeler Real Estate Corporation, and deponent has also many times visited the property and is familiar with the condition thereof, and that the [fol. 191] condition thereof is as reported by Mr. Kelly to the stockholders as stated in his affidavit. That in addition to his trusteeship of the Estate of Ella H. Myers, referred to in said affidavit of Richard Kelly, the deponent's wife holds thirty (30) shares of stock and Fifteen Hundred ($1500.00) Dollars of Income Debentures of Calton Crescent, Inc.

William Henry Hays.

Sworn to before me this 29th day of January, 1942.
Isabel Stahl, Notary Public, Westchester County.

Cert. filed in N. Y. Co. No. 1001, Reg. No. 3-S-629.
Cert. filed in Bronx Co. No. 52, Reg. No. 222-S-43.
Commission expires March 30, 1943.

[fol. 192] SUPREME COURT, NEW YORK COUNTY

SANFORD BECKER, ET AL., PLAINTIFFS

against

RICHARD KELLY, ET AL., DEFENDANTS

STATE OF NEW YORK,
City and County of New York, ss:

Arvah E. Clay, being duly sworn, deposes and says, that he is one of the defendants herein, and was elected a Director of the defendant Calton Crescent, Inc. on March 2, 1938, and was elected its Treasurer on March 21, 1938, and has at all times thereafter been such Director and Treasurer.

That he has read the foregoing affidavit of Richard Kelly, sworn to the 29th day of January, 1942, and that

the statements in said affidavit are all correct to the best of deponent's knowledge, information and belief.

Deponent particularly states that he received full, detailed reports monthly from Keeler Real Estate Corporation of its management of the property, Calton Court Apartments, and diligently examined the same and conferred as to the same with Keeler Real Estate Corporation, and deponent has also many times visited the property and [fol. 193] is familiar with the condition thereof, and that the condition thereof is as reported by Mr. Kelly to the stockholders as stated in his affidavit.

Arvah E. Clay.

Sworn to before me this 29th day of January, 1942.
Isabel Stahl, Notary Public, Westchester County.

Cert. filed in N. Y. Co. No. 1001, Reg. No. 3-S-629.
Cert. filed in Bronx Co. No. 52, Reg. No. 222-S-43.
Commission expires March 30, 1943.

[fol. 194] Excerpt from Respondents' Exhibit 18

Calton Crescent, Inc.
11 West 42nd Street
New York

May 2, 1944

Mr. Sanford Becker, 11 West 42nd Street, New York 18, N. Y.

Dear Mr. Becker:—

In accordance with our conversation of this morning, I have drafted a letter to be written by Mr. Winter, more fully setting forth his offer to our security holders and giving the information necessary for them to have in forwarding their securities, and I have also drafted a letter to be written to me as president, submitting the same, and I would appreciate it if you would submit these two letters to Mr. Winter, so that the matter can be promptly taken up, and under the circumstances I think it would be proper for us to attend to the mailing of this letter, but as we have no funds it would be necessary for Mr. Winter to pay the expense of printing and mailing the letter, which I understood from you he would probably be willing to do.

• • • • • • •

Before the letter of Mr. Winter is printed he should, I think, submit it to the Corn Exchange Bank so as to be certain that the practice outlined therein will meet with its approval when the securities are presented.

Very truly yours, Calton Crescent, Inc., by (signed) Richard Kelly, President.

[fol. 195] RESPONDENTS' EXHIBIT 19

July 22, 1942	Shea & Co. 150 Broadway	500.—
Aug. 5, 1942	Russell M. Van Kirk, Interlaken	500.—
Aug. 12, 1942	Chas Dean & Co.	5,000.—
Aug. 18, 1942	Carl M. Loeb Rhoades & Co.	2,000.—
Oct. 17, 1942	Alfred T. Brady	50.—
Dec. 28, 1942	Dominick & Dominick	50.—
May 17, 1943	Hart, Smith & Co.	1,500.—
May 20, 1943	Ruby Goldwater	50.—
Nov. 17, 1943	T. B. Bassett, Halsey Stuart Co.	1,000.—
Dec. 8, 1943	Hoppin Bros & Co.	3,000.—
Dec. 8, 1943	Delafield & Delafield	3,000.—
Dec. 15, 1943	Merrill Lynch, Pierce, Ferne	1,500.—
Dec. 15, 1943	Robert D. Sterling	4,000.—
Jan. 17, 1944	J. S. Bache & Co.	1,500.—
Jan. 26, 1944	Brown, Lisle & Marshall	500.—
Feb. 16, 1944	Shea & Co.	5,000.—
Apr. 28, 1944	Ethel T. Kramer	1,500.—
Apr. 28, 1944	Kissel Kinnicutt & Co.	500.—
May 5, 1944	Mirian Ross	1,000.—
May 5, 1944	N. H. Lewis, May & Co.	4,500.—
May 19, 1944	Hoppin Bros & Co.	3,000.—
Oct. 2, 1944	Irving Zauderer	1,250.—
Oct. 2, 1944	Chas & Milton Kimmelman	1,250.—
Feb. 1, 1945	L. D. Sherman & Co.	2,500.—
Feb. 9, 1945	Dorothy E. Nurnberger	500.—
Mar. 1, 1945	Helen T. Barker	500.—
Aug. 20, 1945	Merrill Lynch, Pierce, Ferne	250.—
Nov. 14, 1945	Samuel E. Magid	1,950.—
Nov. 14, 1945	Columbus Trust Co.	500.—
Nov. 14, 1945	Craigmyle, Pinney & Co.	500.—
June 1, 1946	Merrill Lynch, Pierce, Ferne	500.—
June 25, 1946	Toby Erlitz	750.—

[fol. 196] RESPONDENTS' EXHIBIT 22

November 18th, 1943.

Mr. Thomas Thompson, 171 Edmund Avenue, Paterson, New Jersey.

DEAR SIR:

Replying to your letter of November 17th, the stockholders about three years ago authorized a sale of the property at a price, which, after paying all obligations and expenses, might have produced nearly Ten Cents on the Dollar for the bondholders. The purchaser, however, defaulted on its contract and forfeited its deposit of $1,000.00.

About a year later another offer was made which might have netted nearly Five Cents on the Dollar for the bondholders and this offer was submitted to the stockholders and failed to receive their approval and the stockholders authorized the borrowing of $15,000.00 to meet past due obligations and a second mortgage to secure its repayment, which was done.

Since then, there appears to have been no improvement in the earnings of the property and about two months ago the possession was taken on behalf of the second mortgagee which had advanced monies to pay taxes and had never received any payment on account of its second mortgage and I can hold out no reasonable hope that anything will be realized for the bondholders. Neither of the above offers could of course have realized anything for the stockholders as the amounts received would have been sufficient only to make a small payment on account of the bonds.

Annual Reports as President and other communications from the officers and directors have from time to time been sent to stockholders and have I assumed been received by you.

Very truly yours, Calton Crescent, Inc., by Richard Kelly, President.

K/CW

[fol. 197] RESPONDENTS' EXHIBIT 23

(Letterhead of)

Calton Crescent, Inc.

11 West 42nd Street

New York

September 14, 1943.

Mr. Alfred F. King, 1230 Sixth Avenue, New York 20, N. Y.

DEAR ALFRED:

Our Secretary, Mr. Norman S. Becker, wrote our Directors on July 30, 1943, explaining the present status of our corporation, which was that the Poughkeepsie Savings Bank was threatening to foreclose its mortgage because of our failure to pay the third-quarter of the real estate tax to the City of New Rochelle, due July 1, 1943, and sent a copy of his letter to Reynolds, Richards & McCutcheon, by reason of the fact that the Estate of J. Berre King is the largest security holder of the corporation.

Since then interest in the sum of $1,832.14 and amortization is the sum of $875, both due August 1, 1943, have been paid to the Poughkeepsie Savings Bank, reducing the principal amount of the mortgage held by the Bank to $161,875, but the taxes due July 1st have not yet been paid, and the corporation, after paying such interest and amortization and its current bills, has no funds with which to make such payment.

The current receipts of the Company are not more than enough to take care of its current expenses, including interest and taxes, and are also not sufficient to take care of the reduction or even of the interest due on the second mortgage of $15,000, so that there is no reasonable certainty that the corporation, will, in the immediate future, be in better position than it now is, even if the Poughkeepsie Savings Bank [fol. 198] waives further amortization on its mortgage and the holder of the second mortgage takes no action in connection with the principal and interest due thereon.

It is, therefore, appropriate that you should be advised as to the situation as Trustee of the Estate of J. Berre King, so that you may consider whether it is possible for

you, as Trustee, or for the beneficiaries or persons interested in the trust, to do anything either for the assistance of the corporation or for the protection of their own investment in the property.

The present situation of the property is, of course, due very largely to the general decline in the values of real estate in New York City and its suburbs, and to the very excessive assessments of such real estate for taxes and the very high rates of taxes imposed by the various municipalities, and these conditions have made almost every mortgage placed at the time when the original mortgage on Calton Court Apartments was placed, a mortgage not only excessive as a safe investment, but in very many cases a mortgage in excess of the actual value of the property involved.

In addition to these general conditions affecting real estate there is also the fact that Calton Court Apartments was a very poorly constructed building. It is an impressive looking building and it has a beautiful location north of New Rochelle, but it has been described by Mr. Edward A. Keeler, who was our secretary and managing agent until last year, as the worst constructed building that he ever saw. This condition, unfortunately, was not ascertainable on an inspection of the building and was discovered only after our corporation had taken possession and found the enormous additional cost necessary to remedy the original defects of construction.

The condition was briefly described in my annual report for 1937, and I sent you copies of the various printed re-[fol. 199] ports, and in a letter to you, dated January 23, 1942, quoted fully portions of my report which it was considered inadvisable to print and distribute generally.

In addition to this, the cities in Westchester County, like New Rochelle, had been unusually guilty of the imposition of very high assessments on real estate and very high rates of taxes.

During the foreclosure of the original mortgage securing the old bonds, a receiver was appointed, and it was the general opinion that he had filled vacancies in the building with undesirable and irresponsible tenants and thereby created a situation in respect to tenancies which it has been very difficult to deal with.

• • • • • • •

The property was originally managed for us by Mr. Edward A. Keeler, in whom our Directors had full confidence, but he was never able to make provision, after expenses of management and our current expenses, to realize enough to enable us to reduce the amount of the first mortgage as required, in addition to paying interest and taxes.

The property is now being managed for us by the Westchester Trustees and the result of their management does not appear to be substantially better, and we would therefore appreciate any suggestions which you may desire to make as to anything which we can do in the matter so as to avoid, if possible, the foreclosure of the first mortgage and the resulting total loss to all of our security holders.

With best regards,

Very truly yours, Calton Crescent, Inc., by Richard Kelly, President.

K/W

[fol. 200] RESPONDENTS' EXHIBIT 24

(Letterhead of)

Calton Crescent, Inc.

420 Lexington Avenue

New York 18

September 23rd, 1943.

Mr. Alfred F. King, 1230 Sixth Avenue, New York 20, N. Y.

DEAR ALFRED:

At a meeting of the Board of Directors of Calton Crescent, Inc. held yesterday the following resolution was adopted:

> "Whereas, the third quarter of the taxes on Calton Court Apartments due July 1, 1943, and the installment of interest due July 7, 1943, on the second mortgage held by Baset Realty Corporation have not been paid and funds are not available to make either of said payments after first paying or providing for the current operating expenses of the property and by reason thereof Poughkeepsie Savings Bank as holder of the

first mortgage and Baset Realty Corporation as holder of the second mortgage are in position to foreclose the mortgages held by them respectively and it is desired if possible to avoid such foreclosures:

Now, therefore, it is resolved that the officers be and they hereby are authorized in their discretion to make execute and deliver to Poughkeepsie Savings Bank an assignment of the rents of Calton Court Apartments containing such provisions as they in their discretion shall deem reasonable, necessary and proper; and,

[fol. 201] Further resolved that the officers of the corporation upon being furnished with evidence that Baset Realty Corporation has paid past due taxes upon Calton Court Apartments or has paid past due installments of principal or interest due on the first mortgage held by Poughkeepsie Savings Bank be and they hereby are authorized in their discretion to make, execute and deliver to Baset Realty Corporation an assignment of the rents of Calton Court Apartments containing such provisions as they in their discretion shall deem reasonable, necessary and proper unless such rents have previously been assigned to Poughkeepsie Savings Bank by an assignment of rents made, executed and delivered to it as hereinbefore authorized."

I might note that under the first mortgage held by the Poughkeepsie Savings Bank the execution of an assignment of rents to the second mortgagee would entitle the Poughkeepsie Savings Bank to declare the principal sum and interest on the mortgage immediately due, but it is not, of course, likely that they would take advantage of this provision ~~so long as~~ the taxes, interest and amortization were being kept up with reasonable diligence.

I have, of course, no means of knowing whether, and, if so, how soon the Baset Realty Corporation would take advantage of ~~the~~ defaults and commence foreclosure of its own second mortgage.

Very ~~truly~~ yours, Calton Crescent, Inc., by Richard Kelly, President.

K/CW.

P. S.—I am sending a copy of this letter to Reynolds, Richards and McCutcheon, Esqs.—R. K.

[fol. 202] RESPONDENTS' EXHIBIT 25A

December 10, 1943.

Manufacturers Trust Company, 55 Broad Street, New York City.

Attention Mr. Gage

DEAR SIRS:—

In accordance with your request we are quoting figures of the Calton Court Apartments for 11 months of this year;

Collections	Disbursements
\$52,294.80	\$55,618.62

In addition the 2nd mortgagee advanced about \$6,000.— and unpaid current operating bills are about \$4,000.—

We are enclosing letter to the superintendent so that you may make an inspection of the premises.

Yours very truly, Calton Crescent, Inc., Norman S. Becker, Secy.

[fol. 203] RESPONDENTS' EXHIBIT 25B

December 21st, 1943.

Manufacturers Trust Company, Corporate Trust Department, 55 Broad Street, New York 15, N. Y.

DEAR SIRS:—

Enclosed please find our check for \$254.90, in payment of your annual fee and disbursements as Trustee under our Indenture, etc., as per your enclosed statement, which I would appreciate if you would receipt and return.

It has been necessary for us to give an Assignment of Rents to the second mortgagee, who is now in possession of the property collecting rents, and the funds remaining in our possession or otherwise available for us will probably not be sufficient to enable us to make any further payments to you as Trustee or Registrar, or to pay an accountant for the preparation of the annual audit which is required to be filed with you under terms of our Indenture and will probably also not be sufficient to pay the expense of preparing and mailing notices of our next annual meeting of stockholders or the usual annual report to our stockholders.

We are, of course, already in default in connection with payments due both to the first and second mortgagee and in the payment of taxes and we are notifying you so that you may be fully advised of the present situation.

Our stockholders have been kept informed of the situation down to the time when they authorized the second mortgage on the property and as we understand that the holders of our debentures under the Indenture of which [fol. 204] you are Trustee are all stockholders it would seem that the holders of said debentures have also been fully advised as to the same.

If by reason of these defaults, it would be your desire to address a communication to the debenture holders for whom you are Trustee, I would be glad to cooperate in the preparation of such communication and give them the full information which would ordinarily be given in my annual report as President so that the persons who are stockholders and holders of debentures may at the same time be fully advised.

Very truly you-s, Calton Crescent, Inc., By Richard Kelly, President.

K/CW
Enc.

[fol. 205] RESPONDENTS' EXHIBIT 25C

Manufacturers Trust Co.
55 Broad Street

December 23, 1943.

Re Calton Crescent, Inc., Property

Calton Crescent, Inc., 11 West 42nd Street, New York, N. Y.

Attention Mr. Richard Kelly, President

DEAR SIRS:—

Receipt is herewith acknowledged of your letter of December 21, 1943, enclosing your check in the amount of $254.90, in payment of our annual fee and disbursements as Trustee. A Duplicate copy of our invoiced acknowledging payment will be sent to you under separate cover.

While we have known for several weeks that your company had given an assignment of rents to the second mort-

gagee—this notice having been given to us as a result of a visit made by Mr. Norman S. Becker, Secretary, with the undersigned—your letter of December 21st represents the first official written notice from your company that certain actions have been taken which may be construed as defaults under the provisions of the indenture.

We are not prepared to say what course, if any, we will pursue, but for your information we have referred our file to our counsel for proper advice and direction. In the meantime, as you already know, we have asked for and received proper letters which would admit our representative to the premises so that a proper report could be made with regard to the condition of the property.

Yours very truly, Frank P. Gage, Trust Officer.

[fol. 206] RESPONDENTS' EXHIBIT 25D

Manufacturers Trust Co.
55 Broad Street

Feb. 2, 1944.

Re Calton Crescent, Inc.

Mr. Richard Kelly, President, Calton Crescent, Inc., 11 West 42nd Street, New York, N. Y.

DEAR SIR:—

I refer you to your letter of December 21, 1943, in which you advised us that the company is without funds to engage a firm of Certified Public Accountants for the preparation of the annual audit, which is required to be filed with the Trustee under the terms of the indenture, and also your offer of assistance in the event we contemplated addressing a communication to the debenture holders.

We have been advised by counsel that the defaults in the indenture, which were called to our attention by Mr. Becker, Secretary, and which are also admitted in your letter of December 21, 1943, should be called to the attention of the debenture holders in an appropriate communication. In order to accomplish this, however, we require the following

information, which we would appreciate your furnishing us at your earliest convenience:

1. Summarized statement of income and expenses for the calendar year 1942, in the form of Exhibit A contained in Schwartz & Holtz's report of December 31, 1942. These figures need not be carried beyond "oper- [fol. 207] ating loss" or "operating profit," whichever the case may be.

2. Resume of the First mortgage setting forth (a) Name of Mortgagee; (b) original date of the Mortgage; (c) Expiration date; (d) Original principal amount of the Mortgage; (e) Unpaid principal amount; (f) Interest rate; (g) Schedule of principal amortization payments.

3. Resume of the Second Mortgage setting forth the same information as requested in respect of the First Mortgage.

4. Copy of the assignment of rents agreement executed between your company and the Second Mortgagee.

In view of your letter of December 21st to the effect that the company has no funds to furnish an audited statement, we will accept for purposes of communicating with the bondholders a similar statement prepared by the treasurer of the company.

Against we request that you please give this your prompt attention.

Yours very truly, Frank P. Gage, Trust Officer.

[fol. 208] Respondents' Exhibit 25E

March 28th, 1944.

Manufacturers Trust Company, 55 Broad Street, New York 15 N. Y.

Att: Mr. Frank P. Gage

Dear Sirs:—

Enclosed please find a statement of our receipts and disbursements for the calendar year 1943 prepared and signed

our Treasurer which we are sending you in lieu of the
dit required by our Indenture since we have no funds with
ich to pay for the making of such audit.

You will note that the statement shows not only our pay-
nts and disbursements, but also the payments and dis-
rsements made by Baset Realty Corporation as mortgagee
possession since September 30th, 1943.

I might note that Baset Realty Corporation paid with its
n funds $500. for coal and $3,616.54 for real estate taxes
ich are included in the second column as paid, by it, and it
o deposited in the special account opened by it as mort-
gee in possession the sum of $1800. of its own money,
ich is, of course, not shown as a receipt in the enclosed
tement.

The enclosed statement shows that all interest and amorti-
ion on the first mortgage and all real estate taxes due
ior to January 1st, 1944, have been paid either by us as
ner or by Baset Realty Corporation as mortgagee, but
re is still due Baset Realty Corporation $375. interest on
second mortgage and also the monies advanced by it as
oresaid. I have no record as to the amount of outstanding
paid operating expenses.

ol. 209] The foregoing gives you, I think, all the infor-
tion we can give which was desired by you for the pur-
se of preparing a letter to the holders of our debentures
d I would personally be very glad to look over your draft
such letter before it is sent out and make any suggestions
ich might occur to me.

Very truly yours, Calton Crescent, Inc., By Richard Kelly, President.

K/CW
Enc.

---

ol. 210] Respondents' Exhibit 25F

April 19th, 1944

nufacturers Trust Company, Corporate Trust Depart-
ment, 55 Broad Street, New York 15, N. Y.

ar Sirs:—

Your bill of April 17th, for $262.98 is received and as
have previously explained to you we have no funds
atsoever available to pay the same and have not even

had funds available to pay our current franchise tax and our only asset is Calton Court Apartments which is in possession of the second mortgagee, as previously explained.

You have written as to your desire to send a letter to the holders of our debentures and if you do so we would appreciate if you would send at least a half dozen copies thereof to our President, Mr. Richard Kelly, at 233 Broadway, so that he may have them available for our file and for our directors and he would be very glad to cooperate with you in the preparation of any such letter which you may desire to send.

Very truly yours, Calton Crescent, Inc., By Richard Kelly, President.

K/CW.

[fol. 211] OBJECTOR'S EXHIBIT 8

Minutes of Special Meeting of Board of Directors of Calton Crescent, Inc. Held April 7, 1942

Included in these minutes was a communication of Myles B. Amend dated April 7, 1942, addressed to Baset Realty Corporation and Calton Crescent, Inc., from which the following is an excerpt:

"I acknowledge receipt from Baset Realty Corporation of two checks of Sanford Becker, one for $12,500.00 and the other for $2,500.00 representing the loan to be secured by the bond and mortgage above referred to."

[fol. 212] OBJECTOR'S EXHIBIT 9 FOR IDENTIFICATION

Law Offices

Richard Kelly

233 Broadway

Richard Kelly
George E. Ferguson

New York April 16th, 1942

Mr. Sanford Becker, 11 West 42nd Street, New York City

DEAR MR. BECKER:—

In case any of the stockholders of Calton Crescent, Inc. desire to participate in the second mortgage, you may be interested in the form of certificate which was used in con-

nection with the second mortgage placed upon the property at the time of the reorganization for the purpose of providing for the payment of the Protective Committee and various other expenses which could not be taken care of out of the first mortgage originally placed.

The form is, of course, entirely different from what you would want to use, but the provisions thereof may be suggestive as to what should be contained in any certificate given evidencing the purchase of an interest in the new second mortgage.

Presumably, it would not be desirable to have any instrument in connection therewith put on record in the Register's Office.

Very truly yours, Richard Kelly.

K/CW. Enc.

[fol. 213] OBJECTOR'S EXHIBIT 24

To the Stockholders of Calton Crescent, Inc.:

At our Annual Meeting, held February 17, 1942, Mr. Sanford Becker, who holds $5,000 of our income debentures and 100 shares of our stock, representing an original investment of $10,000., offered to procure for us a second mortgage loan of $15,000.

At the same meeting, Mr. Becker stated that any stockholder might participate in the proposed second mortgage in propo-tion to his holding. Practical considerations require that any such participation shall be in units of not less than $100., and the mortgagee authorizes us to state that it will divide the mortgage into 150 parts of $100. each, all equal in rights; that any stockholder of this corporation who desires to purchase one or more of such parts at par may do so by notifying Mr. Sanford Becker, at 11 West 42nd Street, New York City, on or before April 25th, 1942, and remitting to order of Baset Realty Corporation the par value of the parts desired; that each stockholder may purchase one part for each 35 shares of stock held on April 1st, 1942; and a holder of less than 35 shares may purchase one part of the mortgage, if there is any part not purchased by holders of more shares; and that all remittances by stockholders for whom no part is available will be promptly returned.

Dated April 7, 1942.

Richard Kelly, President; Wm. Henry Hays, Vice President; Myles B. Amend, Director.

[fol. 214] OBJECTOR'S EXHIBIT 27

Cash Receipts and Disbursements by or for the Benefit of Calton Crescent, Inc. for 1943

Receipts	By Owner	By Mortgagee	Total
Rent (not including employees' apts.)	$42,473.80	$14,581.00	$57,054.80
Miscellaneous Income	114.72	....	114.72
Total Collections	$42,588.52	$14,581.00	$57,169.52
Paid by owner to Mortgagee	345.00	345.00	....
Adjusted Total Receipts	$42,243.52	$14,926.00	$57,169.52
Payments			
Interest on First Mortgage	$ 5,524.75	$ 1,824.48	$ 7,349.23
Interest on Second Mortgage	375.00	....	375.00
Real Estate Taxes	7,190.78	7,174.41	14,365.19
Advertising	122.80	97.80	220.60
Accounting	200.00	....	200.00
Boiler Conversion	679.00	....	679.00
Bus Operation	152.52	....	152.52
Collection Fees	119.00	....	119.00
Decorating	3,035.50	1,662.63	4,698.13
Directors' fees	140.00	....	140.00
Exterminator	45.00	10.00	55.00
Elevator Maintenance	416.00	208.00	624.00
Franchise Tax	107.59	....	107.59
Fuel	5,025.69	2,629.11	7,654.80
Gas and Electric	1,779.56	562.99	2,342.55
Garbage Removal	136.00	60.00	196.00
Garbage Payroll	900.00	352.74	1,252.74
Insurance	1,305.97	265.80	1,571.77
Management Fees	1,155.60	535.20	1,690.80
Miscellaneous	249.43	34.23	283.66
Legal Fees	392.50	....	392.50
Payroll (not including apts. occupied)	3,874.41	1,333.26	5,207.67
[fol. 215]			
Refrigerator Maintenance	....	158.75	158.75
Repairs and Replacements	2,078.67	1,034.07	3,112.74
Renting Expense	93.00	69.00	162.00
Roof Maintenance	160.00	15.00	175.00
Salaries of President and Secretary (Less $9 FOAB)	891.00	....	891.00
Supplies	1,261.05	408.41	1,669.46
Social Security Taxes (F.O.A.B.)	187.54	....	187.54
Stationery and Postage	75.45	20.25	95.70
Telephone	99.02	46.98	146.00
Trustees' Fees	254.90	....	254.90
Unemployment Insurance Tax —Federal	48.89	....	48.89
Unemployment Insurance Tax —State	239.32	....	239.32
Victory and Income Taxes Withheld and Paid	199.22	....	199.22
Water	1,001.80	327.42	1,329.22
Amortization of First Mortgage	2,625.00	875.00	3,500.00
Mechanical Refrigerators	1,561.53	177.75	1,739.28
Total Disbursements	$43,703.49	$19,883.28	$63,586.77

I hereby certify that the foregoing statement correctly shows the receipts and disbursements of Calton Crescent, Inc., as shown by its records, and the receipts and disbursements of Baset Realty Corp. as mortgagee in possession as shown by the monthly statements of its managing agent.

SANFORD BECKER
Treasurer

[fol. 216] OBJECTOR'S EXHIBIT 29

Calton Crescent, Inc.

11 West 42nd Street

New York 18, N. Y.

To the Stockholders of Calton Crescent, Inc.

Notice is hereby given that the Annual Meeting of the stockholders of Calton Crescent, Inc. will be held on the 15th day of February, 1944, at Three o'clock in the afternoon at the office of the Company, 11 West 42nd Street, New York, N. Y., for the purpose of electing directors of the Corporation and for the transaction of such other business as may properly come before the meeting.

Dated, New York, January 26th, 1944.

Norman S. Becker, Secretary.

Postscript by the President:

Your personal attendance is urged, especially since the company has no funds available to present and forward to stockholders the earning statement and balance sheet, as has been done in previous years, and the officers cannot assume the burden of answering letters inquiring as to the business or condition of the company, and stockholders desiring such information will have to examine the books and records of the company at its office.

Whether or not you expect to attend the meeting, please execute and return the enclosed proxy (which you may revoke at any time and which will be used only if you do not attend) so that we may be certain of a quorum.

We have been required to discontinue the bus, which combined with gasoline rationing, deprives our tenants of reasonable transit facilities.

[fol. 217] The net results of the operation continued insufficient to meet current obligations. On September 30, 1943, the company had not paid the taxes due July 1, 1943, and had made no payment on account of interest on the second mortgage, and had no funds available to pay either, and its funds on hand were even insufficient to pay the amounts then due for its current operating expenses. Baset Realty Corporation, as second mortgagee, demanded possession of the property and an assignment of the rents, to

both of which it was then entitled under the terms of its mortgage, and such assignment was executed and possession given as of September 30, 1943, and Baset Realty Corporation is now in possession collecting rents pursuant thereto. It has continued the "Westchester Trustees" as its managing agent.

Aside from the property itself the only apparent asset of the company is its bank account in which there is now $84.12, from which must be paid $19.19 Federal Unemployment Insurance Tax. This balance is much less than the Franchise Tax which is payable on or before March 1st.

I can express no hope, and certainly no assurance, that operation of the property will be any more productive, or that anything will ever be paid bondholders. Certainly nothing will ever be paid stockholders.

The usual annual audit by Schwartz & Holtz has not been made, since the corporation has no funds to pay for such audit. I have asked our treasurer, Mr. Sanford Becker, who is also a certified public accountant, to prepare a report which may be submitted at the meeting, but which probably will not be ready then.

Respectfully submitted, Richard Kelly, President.

[fols. 218-219] IN THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

In the Matter of CALTON CRESCENT, INC., Debtor

MANUFACTURERS TRUST COMPANY, as Trustee under an Indenture made by the Debtor under date of September 27, 1933, and individually, Objector-Appellant,

against

REGINE BECKER, EMILY K. BECKER and WALTER A. FRIBOURG, Claimants-Appellees

Appendix to Appellant's Reply Brief—Filed January 6, 1949

[fol. 220] IN UNITED STATES DISTRICT COURT

Extracts from Stenographic Minutes of the Hearing Before Referee Olney

COLLOQUY

Page 12*

The Referee (Continuing): He is going to proceed now, I take it, to offer proof of all the allegations in the 16th paragraph of the objection which has been denied; and he doesn't have to go awfully far with his proof, apparently, under Pepper *vs.* Lytton before the burden is cast on the claimant.

EXTRACTS FROM TESTIMONY OF SANFORD BECKER

Pages 188-192

By Mr. Hanlon:

Q. Mr. Becker, do you recollect at the first session being asked the following questions and making the following responses—and I am reading from pages 20 and 21 of the minutes—(interrupted by)

Mr. Kahn: Will you hold that a minute while I get my copy, Mr. Hanlon?

---

* Page references are to the paging of the stenographer's minutes.

Mr. Hanlon: At the bottom of page 20 and the top of page 21.

Q. (Reading):

"Q. What is the nature of Mr. Fribourg's business? A. He is retired.
[fol. 221] "Q. What is the use to which he puts this office desk or space he has? A. I don't know. I have no connection with that.
"Q. You know nothing whatsoever about his affairs then? A. No.
"Q. Were you ever connected with Mr. Fribourg's business in any way? A. Never.
"Q. No association with him in any single venture? A. Never."

You heard Mr. Fribourg testifying the other day about these Winsor apartments in Brooklyn, did you not?
A. Yes.
Q. Located I believe at 3111 Glenwood Road in Brooklyn, New York?
A. Yes.
Q. Did you have any connection with any corporation which owned or operated that building?
A. What do you mean by "connection"?
Q. Just what I said: any connection whatsoever?
A. I had no financial interest in it whatsoever.

Mr. Hanlon: I did not ask you about any financial interest. I ask that the answer be stricken, your Honor.
The Referee: Strike it.

Q. Answer the question, please, Mr. Becker.
A. I had no connection, except to do professional work for it.
Q. That is your answer?
A. Yes.
Q. Now, that property at one time was owned by a concern known as Thirty-One-Eleven Corporation, was it not?
A. I don't know.
Q. You don't?
A. It may have.
[fol. 222] Q. Do you know whether it is now owned by a corporation known as Winsor Buildings, Inc.?
A. I don't know.

Q. Do you know anything at all about Winsor Buildings, Inc.?

A. Not very much except the work that I do for it.

Mr. Hanlon: Your Honor, I offer in evidence at this point a certified copy, certified by the County Clerk of Kings County, of a certificate of change of name from Thirty-One-Eleven Corporation to Winsor Buildings, Inc.

Mr. Kahn: I object to this, your Honor.

Mr. Hanlon: The purpose of that, your Honor, is to show that Mr. Sanford Becker who has denied all connections with these ventures, except just as accountant and had nothing to do with it, signed that certified copy as secretary of the corporation and Mr. Fribourg signed as president of the corporation.

Mr. Kahn: Your Honor, this gentleman called Mr. Becker as his own witness.

(Further oral argument followed.)

The Referee: Overruled.

Mr. Kahn: I have my objection on the record.

(Document is received in evidence and marked, "Objectant's Exhibit 17" of this date.)

Q. There is no dispute, is there, Mr. Becker, that you are the Sanford Becker who signed the original of which this is a photostat?

A. No.

The Referee: What is the answer?

Mr. Hanlon: He says "No."

[fol. 223] Q. Do you know, Mr. Becker, where Winsor Buildings, Inc. keeps its bank account?

A. No.

Q. Or any bank account?

A. I wouldn't know.

Q. Do you ever remember signing a signature card for any bank account?

A. Yes, I signed many signature cards.

Q. (Continuing:) For Winsor Buildings, Inc.?

A. I may have.

Q. I show you what purports to be a signature card for the Manufacturers Trust Company and I ask you if that is not your signature opposite the typewritten one, "Sanford Becker, Secretary"?

A. It most assuredly is.

Q. Do you recognize also the other two signatures on there?

A. Yes, of course.

Q. Whose are they?

A. My brother's and Walter A. Fribourg.

Q. And whose handwriting is that at the bottom, the words being "any one officer"?

A. Evidently Fribourg's.

Mr. Hanlon: I offer that in evidence, your Honor.

Mr. Kahn: I make the same objection.

Mr. Hanlon: I ask, however, that the photostat be marked instead of the original. The original will have to be returned to the bank for its records.

Mr. Kahn: Just a minute, give me an opportunity to examine it.

The Referee: All right, mark them both and give the original back to the bank.

(Original and photostat are both received in evidence and marked, "Objectant's Exhibit 18" of this date.)

* * * * * * *

[fol. 224] Pages 195-196

By Mr. Hanlon:

Q. Now, is there a telephone in your office at 11 West 42nd Street with the number Pennsylvania 6-0569?

A. Yes.

Q. That is in your same suite of offices?

A. That is Mr. Fribourg's 'phone.

Q. Mr. Fribourg is in your suite?

A. That is correct.

Q. And he has the telephone number Pennsylvania 6-0569?

A. That is correct.

Q. And that is the telephone number of the Winsor Buildings, Inc.?

A. I don't know.

Q. I show you the same telephone directory that I showed you before and ask you——

A. It is so listed there.

Q. That is correct?

A. I don't know whether it is their telephone or not. I know Fribourg ordered the telephone and paid for it; it is on his desk.

Q. I am only asking you is that a correct listing: Pennsylvania 6-0659?

A. I don't know whether it is the same or not.

Q. And you don't, despite the fact, Mr. Becker, that Winsor Buildings, Incorporated has its office in the same suite occupied by you, your brother and Fribourg?

Mr. Kahn: Just a minute, Mr. Hanlon. No one disputes the fact that Winsor has a telephone in that office.

• • • • • • •

[fol. 225] Page 201

By Mr. Hanlon:

Q. Weren't you at one time, until about 1935, vice-president and treasurer of Julius Grossman Shoes Corporation?

A. Vice-president?

Q. Or treasurer of Julius Grossman Corporation?

A. No.

Q. Weren't you an officer of that corporation?

A. No.

Q. You were accountant of the corporation, weren't you?

A. At one time I was.

Q. During what period?

A. I don't remember. Quite some years ago.

Q. Mr. Fribourg was connected with the company at the time you were, was he not?

A. Yes.

Q. You knew Mr. Fribourg at the time he was connected with that company?

A. I knew Julius Grossman about thirty years.

Q. You knew Mr. Fribourg and Julius Grossman?

A. Yes, of course.

Q. And in connection with your accounting work you had contact with him, did you not?

A. Some, yes.

[fol. 226] OBJECTOR'S EXHIBIT

(Extract from Debenture Indenture)

3:06. The Board of Directors of the Company shall on or before February 15th, 1935, and thereafter annually on or before each February 15th until and including the February 15th next succeeding the date of maturity of the Debentures, file with the Trustee a summarized statement in form satisfactory to the Trustee prepared and signed by a certified public accountant satisfactory to the Trustee showing the amount of the Applicable Income for the preceding calendar year ended December 31st and the basis or method of ascertaining same. Whenever any Debentures are entitled to interest on only a portion of the preceding calendar year, as in this Indenture provided, such statement shall also contain a computation of the interest declarable on such Debentures for that portion of the year for which they are entitled to have interest computed. A duplicate of such statement shall be kept at the office of the Company and shall be open to inspection and copying at any reasonable time during business hours by any debenture holder, or his duly authorized representative. Simultaneously with the filing of such accountants' statement the Company shall also file with the Trustee a statement signed by the Treasurer or an Assistant Treasurer of the Company setting forth the amount of interest, if any, declared and paid on the Debentures for said next preceding fiscal year out of the Applicable Income of the Company, if any, as shown by such accountants' statement. The Company will also, upon the request of the Trustee from time to time, furnish the Trustee with such additional evidence of the payment of interest on the Debentures as the Trustee may reasonably require.

[fol. 227] IN UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT—OCTOBER TERM, 1948

No. 111

(Argued January 3, 1949 Decided March 3, 1949.)

Docket No. 21112

In the Matter of CALTON CRESCENT, INC., Debtor

MANUFACTURERS TRUST COMPANY, as Trustee under an Indenture made by the Debtor under date of September 27, 1933, and individually, Objector-Appellant,

vs.

REGINE BECKER, EMILY K. BECKER and WALTER A. FRIBOURG, Claimants-Appellees

Before L. HAND, SWAN and CHASE, Circuit Judges:

Appeal from the United States District Court for the Southern District of New York

[fol. 228] In an arrangement proceeding under Chapter XI of the Bankruptcy Act by Calton Crescent, Inc., debtor, Manufacturers Trust Company, as indenture trustee and individually, filed objections to the claims of three creditors. From an order of the district court, 80 F. Supp. 822, confirming an order of the referee which dismissed the objections and allowed the claims in full, the objector has appealed. Affirmed.

Beekman & Bogue, Attorneys for appellant; Edward K. Hanlon and Bertrand L. Kohlmann, of counsel.

David W. Kahn, Attorney for appellees.

Roger S. Foster, General Counsel, George Zolotar and David Ferber, Special Counsel, for Securities and Exchange Commission as Amicus Curiae; W. Victor Rodin and Ezra Weiss, of counsel.

Opinion

Swan, Circuit Judge:

This appeal brings up for review an order with respect to the claims of three creditors, the appellees, in an arrangement proceeding under Chapter XI of the Bankruptcy Act, 11 U. S. C. A. §701 *et seq.* The debtor, Calton Crescent, Inc., was formerly the owner of an apartment house located in New Rochelle, New York. In January, 1946, it sold the apartment house, which was its only property, and in May 1946 filed its petition for arrangement. Thereafter the purchase price received for the property was converted into cash, and the debtor is now able to pay a dividend in its arrangement proceeding of 43.61% to the holders of [fol. 229] its debenture bonds. The appellees, being the holders of certain of such bonds, filed claims based thereon for the face amount thereof. The appellant, Manufacturers Trust Company as trustee under the indenture pursuant to which the debenture bonds were issued and in its individual capacity as a creditor,[1] filed objections to the appellees' claims on the ground that the circumstances under which their bonds were acquired make it equitable to subordinate their claims to those of the other debenture holders so as to limit the dividends payable to the appellees to what the bonds actually cost them. The referee in bankruptcy dismissed the objections and allowed the appellees claims at their face amount. This order was confirmed by the district court, 80 F. Supp. 822, and the objector has appealed. The legal questions presented are, first, whether the issue as to subordination is to be determined by state law or federal law and, second, whether, under the law found applicable, the appellees' dividends should be limited as the objector contends.

As to the first question the appellant is right—federal law controls the distribution to creditors in bankruptcy. The Supreme Court has declared the rule very definitely. In *Prudence Realization Corp.* v. *Geist*, 316 U. S. 89, the court said at page 95:

> "* * * The court of bankruptcy is a court of equity to which the judicial administration of the bankrupt's

---

[1] Its claim as a creditor in the sum of $1,587.50 represents fees and disbursements due it as indenture trustee.

> estate is committed, Securities & Exchange Commission v. U. S. Realty Co., 310 U. S. 434, 455-457, and it is for that court—not without appropriate regard for rights acquired under rules of state law—to define and apply federal law in determining the extent to which [fol. 230] the inequitable conduct of a claimant in acquiring or asserting his claim in bankruptcy requires its subordination to other claims which, in other respects, are of the same class."

Later cases have reiterated the rule. *American Surety Co.* v. *Sampsell,* 327 U. S. 269, 272; *Heiser* v. *Woodruff,* 327 U. S. 726, 732; *Vanston Committee* v. *Green,* 329 U. S. 156, 161-163. For earlier cases on the general subject, see *Pepper* v. *Litton,* 308 U. S. 295, 303-4; *American Ins. Co.* v. *Avon Park,* 311 U. S. 138, 146. From these decisions we understand the rule to be that, although the state law determines the title, validity and amount of a claim, the bankruptcy law, including what federal judges think to be equitable, determines what dividends shall be distributable to the claimant. In other words, in addition to those modifications which the Bankruptcy Act itself has imposed upon distribution with respect to preferences, priorities and the like, the courts must impose any other modifications which they deem necessary in the interest of justice.

In the case at bar validity and amount of the bonds held by the appellees are not in dispute; nor is the legal title. The appellant does contend, however, that it is inequitable to allow them to recover full dividends. The amount of their respective claims and the cost thereof are as follows:

Claimant	*Face am't of bonds*	*Cost*
Regine Becker	$44,500	$3,060.63
Emily K. Becker	52,800	5,010.00
Walter A. Fribourg [2]	50,000	2,124.80

[fol. 231] The aggregate dividend payable upon the three claims amounts to $64,237.53, while the aggregate cost of

---

[2] Fribourg's claim as filed was for $55,000. Objection was withdrawn as to $5,000 of bonds acquired by him under circumstances which the objector concedes entitle him to the full dividend thereon.

their bonds to the claimants was only $10,195.43. The difference, namely, $54,042.10, the appellant contends, must be distributed under equitable bankruptcy principles to the other holders of debenture bonds. These holders whose bonds aggregate $107,150 (including the $5,000 of bonds mentioned in note 2, *supra*) will therefore receive approximately 94% of the face value of their claims. Before passing to a consideration of the equitable principles which are said to require this rather extraordinary result, a statement of the facts should be made.

The debtor was organized in 1933 to take title to the New Rochelle apartment house pursuant to a plan of reorganization necessitated by the foreclosure of a mortgage executed in 1927. Under this plan a new first mortgage of $175,000 was placed on the property and the debtor issued its debenture bonds, in the authorized principal amount of $256,800, which were to mature in 1953 and to bear interest, not exceeding 6% per annum, if declared by the directors out of net earnings for each calendar year. These bonds, together with the debtor's capital stock, were issued to the holders of participation certificates in the old 1927 mortgage, one share of stock and $50 of debenture bonds being exchanged for each $100 of participation certificates. The total amount of debentures issued was $254,450, debentures of the face amount of $2,350 being retained for certificate holders who had not deposited their certificates. No interest has ever been paid on the debenture bonds.

Early in 1942 the debtor submitted to its shareholders an offer from a prospective purchaser to pay $220,000 for the apartment house, but the proposed sale did not obtain the requisite approval by the stockholders. Had the sale been approved the debenture bondholders would have re- [fol. 232] ceived about five cents on the dollar on the face amount of their bonds. One who opposed the sale was Sanford Becker, the holder of 50 shares of stock and $5,000 face amount of debentures. Being in default under its first mortgage the debtor was in a precarious condition. Sanford Becker offered to find a client who would lend the debtor $15,000 upon a second mortgage on condition that he and his Brother Norman Becker be given places on the debtor's five man board of directors and be allowed to select the real estate agent to manage the property; the debtor imposed the further condition that all shareholders and

debenture holders be given an opportunity to participate in the proposed second mortgage. In April 1942 this offer was accepted by the debtor, but none of its shareholders or debenture holders except Fribourg, availed themselves of the opportunity to participate in the second mortgage. The Becker brothers were then elected directors; Sanford became treasurer and Norman secretary, and Mr. Kelly continued as president. Sanford Becker's clients who lent the money secured by the second mortgage were his mother, Regine Becker, his wife, Emily K. Becker and his friend, Walter A. Fribourg. They each advanced $5,000.[3] Neither of the Becker ladies was a shareholder or debenture holder at this time; Fribourg had shortly before acquired 50 shares of stock and $5,000 of debentures.[4] On three occasions thereafter, when the debtor again came into default under its first mortgage, the appellees advanced further sums, aggregating about $8,000, to enable such defaults to be cured.[5] These further advances were repaid without interest during 1945. The second mortgage was always in [fol. 233] default from the end of 1942 but the appellees never threatened to foreclose it and, after the debtor's property was sold in January 1946, it was paid in full with interest. In October 1943 when both the first and second mortgages were in default the appellees obtained an assignment of rents;[6] the property, however, continued to be operated, as before, by the same managing agent. In the summer of 1944, the three directors other than the Becker brothers, sold their stock and debentures and resigned as officers and directors of the debtor. Their places as directors were filled by nominees of the Becker brothers, and Norman Becker became president in place of Mr. Richard Kelly.

---

[3] The second mortgage was taken in the name of Baset Realty Corporation but it was a mere title holder for the appellees.

[4] These are the debentures mentioned in note 2 *supra*.

[5] To pay overdue taxes $3615.54 was advanced in September 1943, $2305.09 in April 1944, and $2001 in October 1944.

[6] This, like the second mortgage, was taken in the name of the Baset Realty Corporation.

There is no contention that the conduct of the appellees above recounted was "inequitable." It was obviously very beneficial to those debenture holders who retained and have proved their bonds in the arrangement proceeding. It forestalled foreclosure by the first mortgagee, and enabled the debtor to retain its property until it could be sold for a price of $300,000, which is enough to enable all debenture holders to receive a dividend of 43.61% on the face amount of their bonds. No complaint is made as to the price at which the debtor sold, nor is it suggested that the debtor should have sold sooner at a lesser price or have postponed the sale in the hope of obtaining a better price.

The "inequity" which is said to require that the dividend distributed to the appellees be less than that payable to the other bondholders arises out of the time when, and manner in which, the appellees acquired their bonds. At all times when the bonds were purchased by or for them the debtor was insolvent in the bankruptcy sense.[7] During the period [fol. 234] between April 1942 when the Becker brothers became directors, and the date when the debtor filed its petition for arrangement, May 23, 1946, the appellees acquired the bonds upon which their claims are based.[8] Their own money was used in buying these bonds and neither of the Becker directors had any financial interest in the debentures bought by the appellees. Regine Becker bought her $44,500 of debentures between February 2, 1944 and August 30, 1945 inclusive, from E. Henry Sondheimer Company, a broker who dealt in over-the-counter securities. Sondheimer had originally acquired them for Fribourg but as the latter did not want them they were bought by the Becker ladies. Emily K. Becker bought her $52,800 of debentures between May 24, 1944 and February 5, 1945 inclusive; $7,750 were bought from the Sondheimer Company in the same manner as were Regine Becker's; $37,500 from the King estate which was represented by Reynolds, Richards & McCutcheon, one of whose partners was a director

---

[7] Finding 55. Insolvency probably existed throughout the entire period of the debtor's ownership of the apartment house property, but the referee made no finding as to insolvency during earlier years.

[8] Except for one $500 bond purchased by Fribourg at a cost of $131.05 on June 4, 1946.

of the debtor; and $7,550 from the Y. W. C. A. through one Clay, a member of the Association's investment committee and also a director of the debtor, who was kept fully informed of the debtor's financial condition. Fribourg's $50,000 of debentures were acquired between July 31, 1942 and June 4, 1946, inclusive. Many of Fribourg's debentures were bought from the Sondheimer company or other brokers. $8,250 were required from Mr. Kelly when he resigned as president and a director in 1944. He insisted that the offer made to him by Fribourg in the name of the latter's brother-in-law, one Charles G. Winter, be extended to all the debenture holders, and Kelly notified all stockholders of the offer and of his intention to accept it. Some of Fribourg's holdings were acquired as a result of that [fol. 235] offer. Another $8,500 were purchased from Mr. Hays, vice-president of the debtor. The Becker ladies in investing their money in the debentures exercised no independent judgment; their bonds were bought for them by Sanford or Norman Becker. The former was optimistic about the future of the debtor and thought that the termination of the war would be followed by an enhancement of the value of its property. Norman Becker was pessimistic and discussed his point of view with his mother and Fribourg. Fribourg testified that he invested in the debentures as a "gamble" on his own judgment. He apparently obtained some information from the Becker brothers, in whose office he had desk room, since he furnished Sondheimer with a list of the debenture holders which Sondheimer used in sending them inquiries as to whether they would sell. During the period when the appellees were purchasing their debentures the debtor was receiving frequent inquiries from brokers as to terms on which its property might be bought, but no "firm" offer to buy was submitted after the offer rejected by the shareholders in 1942 until receipt of the $300,000 offer which the debtor accepted in January 1946. The referee concluded that the proofs of debt filed by the Becker ladies should be treated as if they were proofs of debt filed by directors, but that Fribourg's proof of debt should not be so treated. The district court concluded that his claim also should be treated as filed by a director.

One contention of the appellant is that the appellees are disqualified from profiting by their transactions in the

debtor's securities because they acquired them by using information obtained from the Becker directors without adequate disclosure to the sellers. The non-disclosure is said to consist in failure to inform the sellers of (1) the inquiries of brokers as to the terms on which the property [fol. 236] might be purchased; (2) the fact that the appellees were the owners of the second mortgage taken in the name of Baset Realty Corporation; and (3) the fact that they were purchasing debentures. The referee stated that a finding that overreaching or concealment was practiced in the purchase of the securities was not warranted,[9] and the district court said that the record did not show this finding clearly erroneous. The appellant wishes us to overrule this finding, but we agree with the district judge that it is not shown to be clearly wrong.

Furthermore, it should be observed that no seller is complaining that he was overreached in parting with his securities, as was the case in *Strong* v. *Repide*, 213 U. S. 419, upon which appellant puts great reliance. Such sellers as the King Estate, Kelly, Hays and the Y. W. C. A. had as full information as to the debtor's financial condition and the prospect that its property might increase in value after the end of the war as did the appellees. As to securities purchased from over-the-counter traders, such as the Sondheimer Company and other brokers we should hesitate to lay down the rule that the purchaser from a broker must

---

[9] This was finding 54. There is also finding 30:

"There is no evidence to support a finding that Fribourg in connection with his purchases was acting on any information of an inside nature imparted to him by any officer or director of debtor—something not known to and of which the stockholders were not informed."

And finding 40:

"The record does not warrant a finding of offers to purchase the debtor's said property for sums increasing in amount from the Spring of 1942."

And finding 43:

"From the time that the Chesterbrook Estate offer was turned down until the time of the sale in 1946, nothing which would be called an actual firm offer was made for debtor's property."

make disclosure of why he thinks the purchase a desirable [fol. 237] investment under penalty of being charged with overreaching if he fails to do so.

The appellant's other line of attack rests on two premises, (1) that because of the appellees' relationship to the Becker directors they can stand no better than the Becker brothers themselves would stand if they had invested their own money in the purchase of the securities, and (2) that under equitable principles it is a breach of fiduciary duty for a director to buy the company's securities during its insolvency, and consequently he cannot be allowed to make a profit from such purchases.

For the moment we pass the first premise and direct attention to the second. It is, of course, axiomatic that a fiduciary will not be permitted to profit at the expense of his cestui from any transaction where his fiduciary duty and his personal interest may come into conflict.[10] This principle, however, does not preclude a director from purchasing a claim at a discount and collecting its face amount, if his company is solvent, since who holds the debt can be of no concern to a solvent company. It is not immediately apparent why insolvency should make a difference. It will cost the debtor no more whether the dividend which it may be able to pay creditors goes to the original holder of the debt or to a director-assignee. Counsel for the Securities and Exchange Commission suggests that insolvency creates a possible conflict between duty and personal interest because the directors can choose the time for filing a bankruptcy petition and may accelerate or postpone it if doing so can result in a personal profit. The argument as to the timing of bankruptcy has no force after the petition has been filed, yet the law is better settled with respect to purchases made after the petition is filed than those [fol. 238] made before.[11] After insolvency it may be said that the

---

[10] *Magruder* v. *Drury*, 235 U. S. 106, 119 is often cited for this well-known principle.

[11] In most of the cases cited by appellant the purchases were made after some type of bankruptcy proceeding was pending or was imminent and known to be so by the director. *Monroe* v. *Scofield*, 10 Cir., 125 F. 2d 725, 726; *In re Philadelphia & Western Ry. Co.*, 64 F. Supp. 738, 739, (E. D. Pa.); *In re Los Angeles Lumber Products Co.*, 46 F. Supp. 77, 82 (S. D. Calif.).

directors are fiduciaries for the group of creditors who will share in the insolvent's estate. But the creditors who have retained their claims will suffer nothing whether or not the director is allowed to make a profit from his purchases. If a wrong has been done to any of the group of cestuis, it is to those who sold their claims at a price less than the dividend they would have received had they retained them. If they were suing for the wrong done them, they would have to show something equivalent to a fraudulent non-disclosure. *Strong v. Repide*, 213 U. S. 419. Plainly if the contest for the director's profits was between the wronged cestuis and the unwronged cestuis, the former should prevail. Where it is between the unwronged cestuis and a director, if the former are allowed to prevail it can only be as a disciplinary measure against the director for wronging someone who has not complained of the wrong. That this is the real basis for the rule was recognized by Judge Kirkpatrick in the case of *In re Real Estate Mortgage Guaranty Co.*, 55 F. Supp. 749, 752 (E. D. Pa.) where he said:

> "* * * The doctrine that a receiver may not retain a personal profit made out of his trust is a prophylactic rule. It implements the law's precept that a trustee must give undivided loyalty to his trust. The surcharge is the sanction. * * * In the present case a substantial majority of the ultimate and only beneficiaries of the trust knew of and consented to the receivers earn- [fol. 239] ing these commissions by placing the insurance through his own agency. I think that is a controlling factor and that it gives the court full discretion to deny the surcharge."

The same judge made a similar statement in *In re Philadelphia & Western Ry. Co.*, 64 F. Supp. 738, 741: "This limitation is not imposed upon the theory that such profits belong to the corporation by reason of any property right that it may have in them but is an administrative sanction for the enforcement of the rules of fiduciary conduct set by the law." If the doctrine be recognized as a disciplinary sanction within the discretion of the court to impose or withhold, then, as Judge Kirkpatrick also said in the *Mortgage Guaranty Co.* case, "Each case depends on its own circumstances." In the case at bar, where there was no overreaching of the sellers, we are not convinced that the circumstances are such as to require imposition of the

sanction, even if the proof of debt had been filed by a director of the debtor.

But if we are wrong as to this, and the federal rule, in the case of a director who buys the company's securities after it has become insolvent, is as strict as the appellant contends and requires that he be disciplined by giving his profit to creditors whom he has not wronged, the rule must be extended even further if the appellees are to be limited to the cost of their debentures. We now come to consideration of the premise that the appellees can stand no better than would the Becker directors were they the claimants. This is a question of law upon which the conclusions of the referee and district judge are not controlling on appeal.

The appellees were not directors or officers of the debtor; their own funds were invested, and no officer or director of the debtor has any interest in the debentures they pur- [fol. 240] chased. In the case of *In re Philadelphia & Western Ry. Co.*, 64 F. Supp. 738, 741 (E. D. Pa.) the court declined to limit the claim of J. Prescott Stoughton who was the father of an officer of the debtor corporation. In so ruling he stressed the fact that the father was not a fiduciary who owed a duty to the debtor, that the purchases were made by the father with his own funds and for his sole account, and that neither the son nor any other person associated with the debtor had any interest in his dealings in the bonds of the debtor. For similar reasons he declined to limit the claim of Agnes C. McKernan who was an officer of the Conway Corporation which had a management contract with the debtor for the management of the debtor's business. These two claims present a closer analogy to the purchases at bar than do any of the other cases brought to our attention. It is true that one who "knowingly confederates" with a fiduciary in a breach of trust is not allowed to make a profit from the transaction. *Jackson v. Smith*, 254 U. S. 586, 589. But "knowingly confederating" means more, in our opinion, than investing one's own funds on a "tip" received from an officer or director of a debtor. With respect to Fribourg we see nothing in the record to justify a finding that he did more than this. As respects the Becker ladies, since they exercised no independent judgment in the investment of their funds, they are chargeable with the knowledge of their agent, Sanford Becker. But since there was no overreach-

ing of the sellers when he made the purchases for his wife and mother, we do not think the disciplinary sanction for "knowingly confederating" with a disloyal fiduciary should be imposed.

Viewing the situation broadly it appears that the second mortgage loan and the subsequent advances made by the appellees staved off foreclosure and made possible the [fol. 241] 43.61% dividend now available for all debenture holders. Although the debtor had long been insolvent in the bankruptcy sense, it does not appear that bankruptcy proceedings were at any time contemplated before the filing of the arrangement petition in May 1946. Prior to that time the appellees acquired debentures from owners who were willing to sell and were not overreached. These circumstances do not seem to a majority of the court to afford adequate reason to limit the appellees' dividends to the cost of the bonds and to transfer the balance as a windfall to the other debenture holders. Accordingly the order allowing their claims in full is affirmed.

Dissenting Opinion

L. Hand, Circuit Judge (dissenting):

I agree with my brothers that the decisive question is not one of New York law, but—so far as I can understand—what federal judges think a "fair" distribution between the bankrupt's creditors would be of the salvage from his estate. I can see an apparent anomaly in distributing the profits on a director's purchase among the creditors at large, when they cannot be returned to the seller. However, it appears to me an excuse for doing so that, if equity regards the bonds as improperly acquired, it is more nearly just to distribute any profits among the other creditors, who have not been paid in full, than to leave them in the director's hands; for they are a part of the bankrupt's assets and the creditors have a better claim to them than the director himself. The fact that the former creditor has not intervened to assert his right to them against the director, is not to be taken as the equivalent of an assignment or release.

Whether any of the bonds here in suit were in fact acquired by means which equity regards as improper is another [fol. 242] matter. I agree that the trustee's case broke down, so far as it rested upon the suppression of any specific

nformation that the property was going to increase in alue; and, if the directors' dividends are to be confined o what they paid for the bonds, it must be because, as lirectors, they were not free to deal with the creditors t arms' length. The books are full of declarations that an nsolvent holds his property in trust for his creditors; nd, when the insolvent is a corporation, whose directors vere concededly fiduciaries as to shareholders, they beome doubly fiduciaries of the creditors upon insolvency. 'he shareholders have then lost any interest in the assets, nd the directors must be fiduciaries of the creditors, if hey are to be fiduciaries at all. We can start therefore vith the principle universally recognized that, *prima facie*, o fiduciary deals with his beneficiary on terms of equal dvantage; and that, if he is to avoid that restriction, he nust be able to point to some special circumstance which vill excuse him. The claimants in the case at bar argue hat, since directors may freely buy shares in the market, hey must be equally free to buy debts from creditors after nsolvency, when, as I have just said, creditors step into he place of shareholders. That there is at least a preailing belief in the federal courts to the contrary, the lecisions discussed in my brothers' opinion make clear; hey form a substantial body of opinion, which *Securities nd Exchange Commission* v. *Chenery* * did not disturb.

It seems to me that there are solid grounds for distinuishing between such purchases and purchases of shares. conceive that the law allows a director to increase his take in the company, because it adds to his incentive to nake it succeed; the greater the prize, the greater the ffort; it will dampen his zeal, if his holdings must be frozen fol. 243] at what he has when he is elected. Yet he cannot ncrease them without buying of the shareholders. The ommon-law was unable to effect any compromise between hese opposing considerations, and chose the second; on he other hand, the Securities Exchange Act ** succeeded etter by forbidding "quick turns" in shares by a director, et circumscribing his freedom no further. When the ompany is in process of liquidation, I can see no excuse or allowing the purchase of debts, because, although the

* 318 U. S. 80.

** § 78p (b) Title 15, U.S.C.

director acquires an interest, or an added interest, in the success of the liquidation, he has little or no control over the event, for it is in the hands of the court. Any added incentive which his purchase may contribute is negligible; and the excuse does not exist. Indeed, it is significant that the decisions are clearer against such a purchase than against one made while the company continues as a "going concern." When it does so continue, I doubt if the answer can be put in general terms. The insolvent company may have a good chance of effecting a composition: that is, it may be able to scale down its debts and go on. When that is so, I do not see why the same reasoning which permits a director to buy shares should not allow him to buy up debts. Nevertheless, I should make a distinction between the two situations. Before accepting the excuse in the case of debts, I would put the burden on the director of proving, not only that he genuinely expected by a composition to continue the business, but that his expectation was well founded; and nothing short of both would serve as an excuse. In the case at bar neither was proved, and on this record some at any rate of the purchases appear to me to have been unjustified. Perhaps, if my views had prevailed, it would have been necessary to send the case back for a [fol. 244] trial on the issue I have indicated, but I need not decide that.

It will not be necessary for me to go much into the details. I should not include any bonds bought by a director from a director; surely they stand on an equality. The case is not so plain as to the ladies for whom directors bought bonds. They relied altogether upon the directors' advice and exercised no judgment of their own in deciding to buy. In so doing I think that they became charged with the same equities that would have charged the directors, had they bought on their own behalf. In short, the directors could not pass on to their principals profits which they could not have retained for themselves. The principals were charged with notice of what the agents knew, and therefore the principals were not bona fide purchasers. Finally, it is not important to decide whether Judge Goddard was right in finding that Fribourg's claim should be treated as though it were a director's; or whether the referee was right in deciding otherwise. The correct answer is not altogether clear, and it would be necessary to find it only in case my brothers agreed with my disposition of the chief issue.

[fol. 245] IN UNITED STATES COURT OF APPEALS, SECOND CIRCUIT

Present: Hon. Learned Hand, Chief Judge, Hon. Thomas W. Swan, Hon. Harrie B. Chase, Circuit Judges.

In the Matter of CALTON CRESCENT, INC., Debtor

MANUFACTURERS TRUST COMPANY, as Trustee, etc., Appellant,

v.

REGINE BECKER, et al., Appellees.

JUDGMENT—Filed March 3, 1949

Appeal from the District Court of the United States for the Southern District of New York.

This cause came on to be heard on the transcript of record from the District Court of the United States for the Southern District of New York, and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is affirmed with costs.

It is further ordered that a Mandate issue to the said District Court in accordance with this decree.

Alexander M. Bell, Clerk.

[fol. 246] [File endorsement omitted.]

[fol. 247] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 248] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed June 6, 1949

The petition herein for a writ of certiorari to the United States Court of Appeals for the Second Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

IN THE

Supreme Court of the United States

OCTOBER TERM, ~~1948~~ 1949

No. 55

In the Matter

of

CALTON CRESCENT, INC.,

Debtor.

MANUFACTURERS TRUST COMPANY, as Trustee under an Indenture made by the Debtor under date of September 27, 1933, and individually,

Petitioner,

against

REGINE BECKER, EMILY K. BECKER and WALTER A. FRIBOURG,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF

Edward K. Hanlon,
15 Broad Street,
New York 5, N. Y.,
Counsel for Petitioner.

INDEX

Citations:

PA

Cases:

Statutes:

IN THE

Supreme Court of the United States

OCTOBER TERM—1948

No. ....

In the Matter

of

CALTON CRESCENT, INC.,

Debtor.

MANUFACTURERS TRUST COMPANY, as Trustee under an Indenture made by the Debtor under date of September 27, 1933, and individually,

Petitioner,

against

REGINE BECKER, EMILY K. BECKER and WALTER A. FRIBOURG,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

To the Honorable Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioner, Manufacturers Trust Company, as Trustee under an indenture made by the debtor, and

individually, respectfully prays that a writ of certiorari issue to review an order and judgment of the United States Court of Appeals for the Second Circuit which was entered March 3, 1949, and which affirmed an order of the United States District Court for the Southern District of New York dated July 20, 1948, which in turn affirmed an order of a Referee in Bankruptcy dated July 11, 1947 overruling objections to claims filed by the respondents in a proceeding under Chapter XI of the Bankruptcy Act.

Opinions Below

The opinion of the Referee (A. 100-101*) was dated July 2, 1948. The opinion of the United States District Court for the Southern District of New York, Goddard, J. (A. 116-122) was filed on June 20, 1948 and is reported at 80 Fed. Supp. 822. The opinions in the Court of Appeals for the Second Circuit (C. 8-25) were filed on March 3, 1949 and have not been reported.

Jurisdiction

The order and judgment of the United States Court of Appeals for the Second Circuit, sought to be reviewed, was entered on March 3, 1949. Jurisdiction to issue the writ requested is found in Section 24 (c) of the Bankruptcy Act and in Title 28, United States Code, Section 1254 (1).

Questions Presented

The questions here presented are whether directors of a corporation may purchase its debt securities while it

* References indicated by the letter "A" are to the pages of the appendix to the petitioner's brief as appellant in the Court of Appeals, which is part A of the transcript filed in this Court. References indicated by the letter "C" are to Part C of the said transcript.

s insolvent and enforce them in bankruptcy at their full face value rather than be limited to the actual cost; and, f not, whether their relatives and business associates nay, in cooperation with these fiduciaries, do what the lirectors themselves may not do.

Summary Statement of the Matters Involved

This is a proceeding under Chapter XI of the Bankruptcy Act. The review here requested involves the treatment of claims filed by the three respondents, to which claims your petitioner, both in its capacity as Trustee under the debtor's indenture dated September 27, 1933, and individually, filed objections. The claims of the respondents were based upon certain debentures issued under such indenture and the objections sought to limit such claims to the amount paid by each of the respondents for the debentures respectively. The amounts of these claims as filed and the cost to the respondents of the debentures upon which the claims are based were as follows (A. 75-76):

	Amount of Claim	Cost
Regine Becker	$44,500.00	$3,060.63
Emily K. Becker	52,800.00	5,010.00
Walter A. Fribourg	50,000.00	2,124.80

The dividend payable to the creditors in this estate is 43.61%. Consequently there is involved upon this petition $54,042.10, being the difference between the dividend on the face amount of said several claims and the cost of the debentures to the respondents.

The debtor's only asset was an apartment house in New Rochelle, New York, known as the Calton Court Apartments, which it had acquired from a prior corporate owner

in an equity reorganization. In that reorganization the debtor was formed to take title to the premises and there were issued to the depositing bondholders of the former owner debentures and stock of the debtor, each such bondholder receiving $50 of such debentures and one share of such stock for each $100 principal amount of the old bonds (A. 86, 87).

In pursuance of this plan there were issued and were outstanding $254,450 principal amount of the debtor's debentures. Your petitioner was named as Trustee under the indenture pursuant to which these debentures were issued and has at all times continued to act in that capacity (A. 88).

The reorganization was consummated and the premises conveyed to the debtor in 1933 (A. 88). By early 1942 the debtor was in default under the terms of a mortgage on its property (A. 89) and during the years 1942, 1943 and 1944 it was in a precarious condition, operating continuously at a loss (A. 88).

The debentures in question were purchased by the respondents in the years 1942 to 1945 (A. 75-76) and during all of this period the debtor was insolvent (A. 98).

At the time of the acquisition of these debentures two of the directors of the debtor were Sanford Becker and Norman S. Becker who are brothers. The respondent Regine Becker is the mother of these two directors and the respondent Emily K. Becker is the wife of Sanford Becker (A. 91-92).

The respondent Walter A. Fribourg was a business associate of Sanford and Norman S. Becker, having desk space with them in their office (A. 27-28). Of his relationship with such directors the District Judge stated that he was persuaded "that the evidence warrants a finding that the relationship between Fribourg and the

Beckers was of such a nature with respect to the affairs of the debtor so as to treat his (Fribourg's) proof of debt as a proof of debt of a director" (A. 120).

The purchase of these debentures was apparently carried out as a concerted plan by the Becker brothers and Fribourg. All of the purchases of the respondent Regine Becker were made through an account in the name of Fribourg maintained with one E. Henry Sondheimer & Co. (A. 50-51, 76) and part of the debentures of the respondent Emily K. Becker were acquired in the same fashion (A. 76). The respondents Regine Becker and Emily K. Becker exercised no judgment of their own in purchasing their debentures, their purchases having been handled by Sanford Becker as their agent (A. 97-98).

A considerable part of Fribourg's debentures were acquired as a result of a circular letter sent to the other debenture holders in 1944 under the name of his brother-in-law, one Winter (A. 77-78) and these transactions were handled by Norman S. Becker (A. 58-59) in furtherance of a plan apparently worked out by Sanford Becker (A. 34-38).

The Becker brothers became directors of the debtor on April 7, 1942, and from that time on the office of the debtor was maintained in their offices and their nominee, as managing agent, operated the property (A. 20-22). After June 28, 1944 the three remaining directors of the debtor (there were five in all) resigned and their places were filled by nominees of Sanford Becker, so from that date on the board of directors was completely under the control of the Becker brothers (A. 22-25).

The property was sold in January 1946 for a sales price which ultimately enabled the debtor to be liquidated and resulted in the dividend to creditors above referred to of 43.61% (A. 93).

On May 23, 1946 the debtor instituted the present proceeding by filing a petition under Chapter XI of the Bankruptcy Act (A. 93).

Upon the filing of claims by the respondents, your petitioner objected to said claims upon the ground that while the debtor was insolvent its directors and persons such as the respondents, affiliated with them, related to them or acting in conjunction with them, could not profit from any dealings in debt securities of the debtor and at best they might recover from the estate of the debtor only the amounts actually expended by them with interest. This objection, together with an objection based upon overreaching and failure to disclose, which is not here pressed, was overruled and the claims allowed in full by the Referee. His determination in that respect was affirmed by the District Court (Goddard, J.) whose decision in turn was affirmed by the Court of Appeals (Learned Hand, C. J. dissenting).

The Grounds on Which the Decisions of the Courts Below Rested

While the Referee, the District Court, and the Court of Appeals all overruled your petitioner's objections, as has been stated, no two of them agreed upon the basis for their conclusions.

The Referee took the position that, with certain exceptions not here pertinent, a director, and consequently his associates, may acquire unmatured obligations of the corporation of which he is a director and enforce the same for the full face amount thereof, even if at the time he so acquired the obligations said corporation was insolvent. The Referee based his conclusion principally upon this Court's first decision in *Securities and Exchange Commis-*

sion v. Chenery Corp., 318 U. S. 80, a case which was not in point, involving as it did the reorganization of a public utility under Sections 6 and 11 of the Public Utility Holding Company Act of 1935, where the subject company was not insolvent but was being reorganized in order to divest itself of certain subsidiary companies in accordance with the provisions of that statute.

In the District Court, Judge Goddard held that cases condemning transactions by directors in the debt securities of an insolvent corporation did not cover the situation where the corporation, although insolvent in a bankruptcy sense, is still a "going concern", applying what he deemed to be the rule as laid down in decisions of the New York courts (A. 121-122). Of course, in the instant case the debtor was a "going concern" only so long as the Becker-Fribourg group, who were in complete control, permitted it to remain so.

The prevailing opinion of the Court of Appeals was written by Swan, C. J., Chase, C. J. concurring. The dissenting opinion was written by Learned Hand, C. J.

The majority took the position that the matter was not governed by decisions of the New York courts since the bankruptcy law, including what the federal judges think to be equitable, determines what dividends shall be distributable to a claimant (C. 10); that the wrong, if any, had been done to those who had sold their claims at a price less than the dividend they would have received had they retained them; that where, as here, the contest is between the unwronged cestuis (*i.e.*, the debtor's other creditors) and the directors, if the former are to prevail it can be only as a disciplinary measure; that if the doctrine be recognized as a disciplinary sanction within the discretion of the court to impose or withhold, then each case should depend on its own circumstance, and conse-

quently in the case at bar, where there was no overreaching of the sellers, the majority was not convinced that the circumstances were such as to require the imposition of the sanction, even if the proofs of debt had been filed by directors of the debtor themselves (C. 17-20).

The majority stated further that these particular respondents were not directors or officers of the debtor, that their own funds were invested, and that no officer or director of the debtor had any interest in the debentures purchased; that as to the Becker ladies, while they exercised no independent judgment and are chargeable with the knowledge of their agent, Sanford Becker, there was no overreaching of the sellers. As to the respondent Fribourg, the majority felt that there was nothing in the record to justify a finding that he did more than invest his own funds on a "tip" received from an officer or director of the debtor (C. 20-22).

Judge Learned Hand, in dissenting, pointed out that no fiduciary deals with his beneficiary on terms of equal advantage, that if he is to avoid that restriction he must be able to point to some circumstance which will excuse him; that there was a distinction to be taken between purchasers of stock and purchasers of debt securities; that before accepting the excuse in the case of debts the burden should be put on the director of proving not only that he genuinely expected by a composition to continue the business but that his expectation was well founded, and that nothing short of both would serve as an excuse, and that neither was proved in the case at bar (C. 23-25).

As to the Becker ladies, Judge Hand felt that they were chargeable with what their agents knew and were not bona fide purchasers. As to Fribourg, Judge Hand stated that the correct answer was not altogether clear but it would have been necessary to find it only in case the majority had agreed with his disposition of the chief issue (C. 25).

Reasons Relied on for Allowance of Writ

1. The decision below runs counter to long established and uniformly applied principles with respect to the fiduciary duties and obligations of directors of an insolvent corporation and is erroneous. It has heretofore been consistently held that directors may not traffic in the debt securities of their insolvent corporation and thereafter in bankruptcy proceedings enforce their claims upon such securities beyond the amount which they actually paid for them.

Yet in this case the majority of the Court of Appeals has held to the contrary upon the ground that it did not appear that the sellers of the purchased securities had been overreached.

We know of no federal decision where such a principle has been enunciated. On the other hand, that directors' claims purchased during insolvency should be limited to the amount paid has been held in the following cases:

> *In Re Van Sweringen*, 119 F. 2d 231 (6 C.C.A., 1941; cert. den. sub nom. *Terminal & Shaker Heights Realty Co. v. Van Sweringen*, 314 U. S. 671);
>
> *In Re Norcor Manufacturing Co.*, 109 F. 2d 407 (7 C.C.A., 1940; cert. den. 310 U. S. 625);
>
> *Monroe v. Scofield*, 135 F. 2d 725 (10 C.C.A., 1943);
>
> *In Re Los Angeles Lumber Products Co., Ltd.*, 46 Fed. Supp. 77 (D.C.S.D. Cal. 1941);
>
> *In Re Jersey Materials Co.*, 50 Fed. Supp. 428 (D.C. N.J. 1943);
>
> *In Re Philadelphia & Western Railway Co.*, 64 Fed. Supp. 738 (D.C.E.D. Pa. 1946);
>
> *In Re McCrory Stores Corp.*, 12 Fed. Supp. 267 (D.C.S.D. N. Y. 1935).

While there has been no decision of this Court upon the matter, the decision below runs counter to the principles which have been enunciated by this Court in respect of the fiduciary obligations imposed upon directors. This Court, in *Pepper* v. *Litton*, 308 U. S. 295, a case in bankruptcy, pointed out that the bankruptcy courts were invested with equitable powers, that these powers exist in passing on claims presented by an officer, director or stockholder in the bankruptcy proceedings of his corporation, that a director is a fiduciary, that standards of fiduciary obligation are designed for the protection of the entire community of interests in the corporation, and that one who is in a fiduciary position cannot serve himself first and his *cestuis* second.

Judge Learned Hand in his dissenting opinion below (C. 23) expressed these principles in the following language:

> "The books are full of declarations that an insolvent holds his property in trust for his creditors; and, when the insolvent is a corporation, whose directors were concededly fiduciaries as to shareholders, they become doubly fiduciaries of the creditors upon insolvency. The shareholders have then lost any interest in the assets, and the directors must be fiduciaries of the creditors, if they are to be fiduciaries at all. We can start therefore with the principle universally recognized that, *prima facie*, no fiduciary deals with his beneficiary on terms of equal advantage; and that, if he is to avoid that restriction, he must be able to point to some special circumstance which will excuse him."

That the decision of the court below runs counter to the theory of decisions upon the subject in the federal courts, was also pointed out by Judge Hand when he said, apropos the contentions of the respondents (C. 23):

"That there is at least a prevailing belief in the federal courts to the contrary, the decisions discussed in my brothers' opinion make clear; they form a substantial body of opinion, which *Securities and Exchange Commission v. Chenery** did not disturb."

The prevailing belief to which Judge Hand refers is fully discussed in the very thoughtful opinion of the district judge in *In re Los Angeles Lumber Products Co., Ltd., supra,* 46 Fed. Supp. 77 (D.C.S.D. Cal. 1941).

Consequently the decision below creates confusion in a field where the law was settled, and, since there has never been a decision by this Court upon the question, it is submitted that there should be an authoritative determination of it.

2. The decision of the Court of Appeals in this case directly conflicts with decisions of the Courts of Appeals for the Sixth, Seventh and Tenth Circuits. These decisions are as follows:

Sixth Circuit—*In re Van Sweringen, supra.* There directors of three insolvent corporations, a year before the corporations went into bankruptcy, purchased debt securities of the debtors through the medium of a corporation formed by them and in the ensuing bankruptcy proceedings it was sought to enforce these claims at their face amount. It was held by that court that the claims should be limited to the amount actually paid for the securities, the court pointing out that the debtors were insolvent when the purchases were made, that a trustee can make no profit out of his trust and that the intervention of a dominated subsidiary corporation did not render the principle less effective.

* 318 U. S. 80.

Seventh Circuit—*In re Norcor Manufacturing Co., supra.* There, while the debtor was in a state court receivership, two and a half years prior to the filing of a bankruptcy petition, one Krueger (who was the principal stockholder and a director of the debtor), his attorney and members of his family purchased claims against the debtor and assigned them to a corporation formed for the purpose of enforcing them. It was held by that court that the claims should be limited to the amounts actually paid for them, the court asserting that Krueger and his attorney bore such a fiduciary relationship to the debtor corporation as to preclude them from purchasing claims of its creditors at a small fraction of their face value and using them as a foundation for a claim in excess of what was actually paid therefor.

Tenth Circuit—*Monroe v. Scofield, supra.* There the court expressly held (page 728) that where a corporation is insolvent a director is precluded from recovering more than he paid for a claim against the corporation unless by an order of the court or otherwise he has been shorn of all his power in the corporate management and his trust relationship has been fully terminated.

There are, therefore, decisions of three Courts of Appeals in other circuits, in two of which this Court denied certiorari, which are directly in conflict with the decision of the court below in the instant case.

3. This matter presents a question of recurring importance in the administration of the Bankruptcy Act. That this is so is manifest from the series of decisions over a period of years to which we have heretofore adverted.

It is a question which is to be encountered in every type of bankruptcy whether it be one of liquidation,

reorganization under Chapter X or of arrangement under Chapter XI.

The Securities and Exchange Commission obtained leave from the court below to file a brief *amicus curiae* in support of the petitioner's position, stating to that court:

> "This appeal includes issues of recurring importance in the administration of the Bankruptcy Act, particularly in connection with proceedings under Chapter X thereof (11 U.S.C. 501 *et seq.*) in which the Commission has a statutory interest."

It is to be assumed that up to this time, in view of the uniform flow of the decisions of the lower federal courts, such claims of directors and their relatives and associates have been treated upon the basis for which your petitioner here contends.

It is perfectly manifest that the decision of the court below in this case has completely disturbed the settled view which has prevailed until now, in consequence of which confusion and conflict must necessarily result.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Court of Appeals for the Second Circuit, commanding that court to certify to and send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket No. 21112, In the Matter of Calton Crescent, Inc., Debtor, Manufacturers Trust Company as Trustee under an Indenture made by the Debtor under date of September 27, 1933, and individually, Objector-Appellant, against Regine Becker, Emily K. Becker and Walter A. Fribourg, Claimants-

Appellees, and that the judgment of the said Court of Appeals for the Second Circuit may be reversed by this Honorable Court, and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioner will ever pray.

Dated: New York, N. Y., April 19, 1949.

MANUFACTURERS TRUST COMPANY, as Trustee under an Indenture made by the Debtor under date of September 27, 1933, and individually,

Petitioner,

By EDWARD K. HANLON,
Counsel for Petitioner.

IN THE

Supreme Court of the United States

OCTOBER TERM—1948

No. ....

In the Matter

of

CALTON CRESCENT, INC.,

Debtor.

MANUFACTURERS TRUST COMPANY, as Trustee under an Indenture made by the Debtor under date of September 27, 1933, and individually,

Petitioner,

against

~~REGINA BECKER,~~ EMILY K. BECKER and WALTER A. FRIBOURG,

Respondents.

BRIEF IN SUPPORT OF PETITION

Opinions Below

The opinion of the Referee (A. 100-101) is not reported.

The opinion of the District Court (per GODDARD, J.) (A. 116-122) is reported at 80 Fed. Supp. 822.

The opinions in the Court of Appeals (C. 8-25) are not yet reported.

Jurisdiction

The order and judgment of the Court of Appeals for the Second Circuit sought to be reviewed was entered on March 3, 1949 (C. 26-27).

The jurisdiction of this Court is invoked under Section 24 (c) of the Bankruptcy Act and Title 28, United States Code, Section 1254 (1).

Statement of Facts

The facts have been stated in the petition.

Specification of Errors

It is submitted that the court below erred:

(1) In affirming the decree of the District Court.

(2) In holding that the proofs of claims of the respondents should be allowed in the full face amount thereof.

(3) In failing to hold that directors of an insolvent corporation may not profit from their dealings in debt securities of their corporation and that claims based upon such securities should, upon a distribution of the corporation's assets in a subsequent bankruptcy proceeding, be limited to the actual amounts paid by them for such debt securities.

(4) In failing to hold that the respondents, two of whom were relatives of directors, who exercised no independent judgment of their own and for whom the directors acted as agents, and one of whom was associated with directors and acted in conjunction with them, are to be treated in the same manner as if they were directors in respect of the allowance of their claims upon a distribution of the debtor's assets.

Summary of Argument

I

Directors of an insolvent corporation are fiduciaries, and the standards of their obligations as such fiduciaries are designed for the protection of the entire community of interests in the corporation, and these standards are not satisfied by a mere holding that it does not appear that in purchasing debt securities of their corporation the sellers of such securities were not overreached. Relatives and associates, such as these respondents, are in like position.

II

The decision below is in direct conflict with decisions of the Courts of Appeals for the Sixth, Seventh and Tenth Circuits.

ARGUMENT

I

Directors of an insolvent corporation are fiduciaries, and the standards of their obligations as such fiduciaries are designed for the protection of the entire community of interests in the corporation, and these standards are not satisfied by a mere holding that it does not appear that in purchasing debt securities of their corporation the sellers of such securities were not overreached. Relatives and associates, such as these respondents, are in like position.

It is not disputed that during all the period when the respondents purchased the securities on which their claims are based the corporation was insolvent. Nevertheless

the majority of the Court of Appeals has held that even if the respondents had been directors their claims should be allowed in full because it did not appear that they had overreached those from whom they purchased such securities. We know of no other case where such a principle has been applied.

The real test is whether the corporate fiduciary may act in his own interest, reaping profits from such transactions, or must turn such profits over to the corporation's creditors for whose benefit he should have been acting.

This Court in *Pepper* v. *Litton*, 308 U. S. 295 (1939), in speaking of the fiduciary obligations of directors, said (p. 307):

> "For that standard of fiduciary obligation is designed for the protection of the entire community of interests in the corporation—creditors as well as stockholders."

To ignore the balance of the community of interest and to make the standard of determination harm to the sellers of the securities imports a false conception. A somewhat similar contention was made in *Wendt* v. *Fischer*, 243 N. Y. 439, where brokers brought about the sale of their principal's property to a corporation of which one of them was an officer and director (although not personally interested) and defended their conduct by taking the position that the principal had obtained the terms upon which he was willing to sell. Judge Cardozo repudiated such a test in the following language (p. 443):

> "Finally we are told that the brokers acted in good faith, that the terms procured were the best obtainable at the moment, and that the wrong, if any, was unaccompanied by damage. This is no sufficient answer by a trustee forgetful of his duty. The law

'does not stop to inquire whether the contract or transaction was fair or unfair. It stops the inquiry when the relation is disclosed, and sets aside the transaction or refuses to enforce it, at the instance of the party whom the fiduciary undertook to represent, without undertaking to deal with the question of abstract justice in the particular case' (citing cases). Only by this uncompromising rigidity has the rule of undivided loyalty been maintained against disintegrating erosion.'

That we are not inaccurate in asserting that the court below adopted the very contention which Judge Cardozo repudiated is manifest from the following language in the majority opinion (C. 19):

"After insolvency it may be said that the directors are fiduciaries for the group of creditors who will share in the insolvent's estate. But the creditors who have retained their claims will suffer nothing whether or not the director is allowed to make a profit from his purchases. If a wrong has been done to any of the group of cestuis, it is to those who sold their claims at a price less than the dividend they would have received had they retained them."

It is obvious that this line of reasoning ignores this Court's comment, above referred to, in *Pepper* v. *Litton* (*supra*) that the standards of the directors' fiduciary obligations are designed for the protection of the entire community of interests in the corporation.

The real problem involved here is whether or not the obligations of a director as a fiduciary not to traffic in the trust property are to be maintained. As indicated in the dissenting opinion (C. 23), directors of an insolvent corporation are trustees for its creditors and any profit which they may obtain through self-dealing in the trust assets belongs to their cestuis, in this case the remaining creditors.

The result in the court below, which in actuality emasculates that well settled principle, runs counter to the theory of the decisions upon the subject in both federal courts of appeal and district courts. We will discuss the decisions of the courts of appeals hereafter (Point II) as being in direct conflict with the decision of the court below, and confine our remarks here to references to the decisions of the district courts.

There is a careful and well reasoned discussion of this precise matter in *In Re Los Angeles Lumber Co., Ltd.*, 46 Fed. Supp. 77 (D.C.S.D. Cal. 1941) where a director had purchased substantial amounts of the debt securities of his insolvent corporation, some of which he had bought for the purpose of turning them over to the corporation if it should obtain sufficient funds to reimburse him. As to all of these securities the director was held, in the subsequent bankruptcy proceedings, to be limited to the amount that he paid for such securities. The same result was reached with regard to another corporation which participated with him in some of the purchases with knowledge of the facts. There was no overreaching of the sellers; on the contrary the director advised all bondholders of the debtor who inquired of him not to sell their bonds unless they had to.

The following comments in the court's opinion (p. 88) reflect the principles which have been applied in the federal courts until the decision in the instant case:

> "It has, of course, long been established that officers, directors and attorneys of a corporation are fiduciaries and that they should be held responsible for any breach of duties as such. *They may not, while the corporation is insolvent, purchase claims against it at a discount and then enforce such claims at their full face value.* *Bonney* v. *Tilley*, 1895, 109 Cal. 346, 42 P. 439; *Davis* v. *Rock*

Creek Lumber, etc., Co., 1880, 55 Cal. 359, 36 Am. Rep. 40. When the corporation is not only insolvent but has filed its petition under Section 77B or Chapter X of the National Bankruptcy Act as amended, 11 U.S.C.A. §501 *et seq.*, and the directors have become trustees of the debtor in possession, the directors' obligations as trustees become even more rigorous. *In re Norcor Mfg. Co.*, 7 Cir., 109 F. 2d 407; *Pepper* v. *Litton*, 308 U. S. 295, 60 S. Ct. 238, 84 L. Ed. 281.

The good faith or innocent motives of the fiduciary, or his well-intentioned purpose to effectuate a plan of reorganization, constitute no defense to liabilities founded upon breaches of fiduciary obligations. *In re McCrory Stores, Corp.*, D.C.S.D. N. Y., 1935, 12 F. Supp. 267, 269, 30 Am. Bankr. Rep., N.S., 670.

* * * * * * *

And it is likewise no defense to say that fraud was not intended and that unfairness did not result from the trustee's actions. *Magruder* v. *Drury*, 235 U. S. 106, 120, 35 S. Ct. 77, 59 L. Ed. 151; *Jackson* v. *Smith*, 254 U. S. 586, 589, 41 S. Ct. 200, 65 L. Ed. 418; *Tomblin* v. *Hill*, 206 Cal. 689, 275 P. 941. Actual fraud in such cases is not necessary to give the client redress. A breach of duty is constructive fraud. *Baker* v. *Humphrey*, 101 U. S. 494, 25 L. Ed. 1065. There are many situations, in which a constructive trust is imposed even in the absence of fraud. 3 Scott on Trusts, §462." (Italics supplied.)

District Court cases involving similar situations with like results are *In Re Jersey Materials Co.*, 50 Fed. Supp. 428 (D.C. N.J. 1943), *In Re Philadelphia & Western Railway Co.*, 64 Fed. Supp. 738 (D.C.E.D. Pa. 1946) and *In Re McCrory Stores Corp.*, 12 Fed. Supp. 267 (D.C.S.D. N. Y. 1935).

The circumstance that the respondents were not directors is a little moment here. Two of the respondents

were relatives of the directors, one the mother of Norman and Sanford Becker and another the wife of Sanford Becker. Sanford purchased the debentures as their agent and they themselves exercised no independent judgment in the matter. Fribourg, while not a relative, was an associate of the Becker brothers, his brokerage account was utilized for the purchase of securities for the other respondents and the Becker brothers cooperated with him in the purchase of many of the securities upon which he now bases his claim. Obviously, to permit fiduciaries to conduct transactions forbidden to them, by acting as agents for the mother and wife, and by cooperating with the third respondent in the purchase of securities acquired by him, would be to make a travesty of the basic rule and encourage the very thing which the rule forbids.

Such conduct was not permitted in *In Re Los Angeles Lumber Products Co., Ltd.* (*supra*) in *In Re Jersey Materials Co.* (*supra*) and *In Re Norcor Mfg. Co.*, 109 F. 2d 407 (7 C.C.A. 1940) (discussed hereafter).

Manifestly the decision below has made unsettled what previously was the prevailing belief in the federal courts, as pointed out by Judge Learned Hand in his dissenting opinion in this case (C. 23), and, therefore, raises a question which has not been passed upon by this Court and which should be settled by this Court.

II

The decision below is in direct conflict with decisions of the Courts of Appeals for the Sixth, Seventh and Tenth Circuits.

The decision of the court below is in direct conflict with the decision of the Court of Appeals for the Sixth Circuit in *In Re Van Sweringen Company*, 119 F. 2d 231 (1941

cert. den. sub nom. *Terminal & Shaker Heights Realty Co. v. Van Sweringen*, 314 U. S. 671); with the decision of the Court of Appeals for the Seventh Circuit in *In Re Norcor Manufacturing Co.*, 109 F. 2d 407 (1940 cert. den. 310 U. S. 625); and with the decision of the Court of Appeals for the Tenth Circuit in *Monroe* v. *Scofield*, 135 F. 2d 725 (1943). We will discuss these three cases in the order named.

In Re Van Sweringen Company.—There the Vaness Company was the majority stockholder of two debtor companies, one of which in turn owned all the stock of the Cleveland Terminal Building Company, a subsidiary debtor. The Van Sweringen brothers were officers and directors of all these companies. In May, 1930, the Vaness and Cleveland companies borrowed $39,500,000 from J. P. Morgan & Company evidenced by notes and secured by certain collateral securities. Upon default on the notes in May, 1935, the collateral securities were to be sold at public auction in September. In August of the same year, the Van Sweringens formed the Midamerica Corporation whose successor was the claimant in the proceeding. The agreement setting up this corporation provided that one Ball and one Tomlinson would put up $2,000,000 and the Van Sweringens would have an irrevocable option to purchase 55% of the common stock for a period of 10 years and obtain control of the board of directors. At the auction sale Midamerica bought in the notes of the debtors together with the collateral securities which were conceded to have a value greater than the total amount paid. The notes of the three debtors purchased were carried on Midamerica books at $1, $2 and $887, respectively. The claimant sought in the debtors' reorganization to enforce a claim on these notes at their total face value of $39,500,000.

The court limited the claims to \$1, \$2 and \$887 plus interest from the date of acquisition saying (p. 234):

> "From the manner and under the circumstances in which, in association with outside enterprisors, the Van Sweringens, *as directors of insolvent corporations*, purchased these claims against their cestui que trustent, the debtors, herein, at substantially less than real values, equity and good conscience demand that the claims of their corporate creature, Midamerica (predecessor to appellant), be limited to the amounts actually paid by it for the notes and bonds of the insolvent corporations." (Italics ours.)

In Re Norcor Manufacturing Co.—There one Krueger was the principal stockholder and director of the Norcor Manufacturing Co., the debtor, which had confessed insolvency in the state court. Ten months later Krueger hired an attorney, one Lehner, for the purpose of reorganizing the debtor. Lehner was furnished with a list of stockholders, financial statements and other pertinent data and he then solicited creditors of the debtor, offering to purchase their claims at 10 to 30% of their face value. Krueger assigned his controlling stock to a third person who reassigned the same to the Norcor Company, a new corporation whose board of directors was controlled by Krueger and Lehner. Lehner continued to offer to purchase such claims and assignments of such claims were made to Lehner, his wife, Krueger and Krueger's son, all of whom reassigned such claims to the new corporation. These claims totaled \$65,016.73, for which amount the new company made a claim in the debtor's reorganization. The actual amount paid for such claims was \$13,331.13.

The court limited the claims to the amount actually paid for them, saying (p. 411):

> "It is argued that Krueger and his attorney Lehner sustained such a fiduciary relation with the debtor corporation as would preclude them from purchasing claims of creditors at a small fraction of their face value, and using them as the foundation for a claim in excess of that actually paid therefor. We think this argument is sound. Certainly Krueger, as Managing Director, occupied such position."

The court then quotes from this Court's opinion in *Pepper* v. *Litton* (*supra*) and continues:

> "As Krueger occupied a fiduciary relation, so did his attorney Lehner. Neither of them would have been entitled to the allowance of a claim in an amount which would have inured to his individual profit. Being thus precluded as individuals, they had no right to accomplish the same purpose under the guise of a corporate entity."

Monroe v. *Scofield*.—There a director purchased a judgment against his corporation after the commencement of bankruptcy proceedings against it. The court limited the claim to the amount paid, saying (p. 728):

> "Where a corporation is a going concern, a director may purchase a claim against the corporation at a discount and enforce it for the full amount, absent a present duty on his part to act for the corporation. However, where the corporation is insolvent, he is precluded from recovering more than he paid for the claim unless by an order of the court or otherwise he has been shorn of all power in the corporate management and his trust relationship has been fully terminated."

Each of the foregoing three decisions expressly holds that a director or his associates may not purchase a claim against his corporation while it is insolvent, and enforce it at its full face amount in bankruptcy proceedings.

Whether or not the purchase is made before or after bankruptcy proceedings have been brought is not made a test in any one of these cases. As a matter of fact in the *Van Sweringen* case the reorganization proceedings did not commence until a year after the transaction. (We obtain the date of the commencement of the proceedings from a related case, *Gochenour* v. *Cleveland Buildings Co.*, 142 F. 2d 991, 992 (C.C.A. 6, 1944).) In the *Norcor Manufacturing* case the corporation was in a state receivership but not in bankruptcy. In *Monroe* v. *Scofield* bankruptcy proceedings had begun when the claim was acquired.

Without laboring the point, we submit that it is manifest that the decision in the court below in the instant case is in direct conflict with each of these three decisions.

CONCLUSION

A writ of certiorari should be granted.

Dated: New York, N. Y., April 19, 1949.

Respectfully submitted,

EDWARD K. HANLON,
Counsel for Petitioner.

Supreme Court of the United States

October Term, 1949

No. 55

MANUFACTURERS TRUST COMPANY, as Trustee under an Indenture made by the Debtor under date of September 27, 1933, and individually,

Petitioner,

vs.

REGINE BECKER, EMILY K. BECKER and WALTER A. FRIBOURG,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF OF PETITIONER

Edward K. Hanlon,
15 Broad Street,
New York 5, New York,
Counsel for Petitioner.

SUBJECT INDEX

Table of Cases Cited

Statutes Cited

Other Authorities Cited

Supreme Court of the United States

OCTOBER TERM, 1949

No. 55

MANUFACTURERS TRUST COMPANY, as Trustee under an Indenture made by the Debtor under date of September 27, 1933, and individually,

Petitioner,

vs.

REGINE BECKER, EMILY K. BECKER and WALTER A. FRIBOURG,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF PETITIONER

Opinions Below

The opinion of the Referee (R. 79-80) is not reported in the Federal Reporter or Federal Supplement.

The opinion of the United States District Court for the Southern District of New York (per Goddard, J.) (R. 91-95) is reported at 80 F. Supp. 822.

The opinions in the Court of Appeals for the Second Circuit (R. 175-188) are reported at 173 F. 2d 944.

Jurisdiction

The order and judgment of the United States Court of Appeals for the Second Circuit, here to be reviewed, was filed on March 3, 1949 (R. 189).

The jurisdiction of this Court was invoked under Section 24 (c) of the Bankruptcy Act and Title 28, United States Code, Section 1254 (1).

Certiorari was granted by this Court on June 6, 1949 (R. 189).

Statement of the Case

This case arose in proceedings under Chapter XI of the Bankruptcy Act in which Calton Crescent, Inc., a New York corporation, is the debtor.

The petitioner, Manufacturers Trust Company, of New York City, is trustee under an indenture made by the debtor under date of September 27, 1933, pursuant to which indenture certain debentures of the debtor were issued (F. 7, R. 70).*

The debtor's only asset was an apartment house, in New Rochelle, New York, known as the Calton Court Apartments which it had acquired in 1933 from a prior corporate owner in an equity reorganization. In that reorganization the debtor was formed to take title to the premises and there were issued to the depositing bondholders of the former corporate owner debentures and stock of the debtor, each such bondholder receiving $50 of such debentures and one share of such stock for each $100 principal amount of the old bonds. (F. 2-6, R. 69-70.)

The reorganization was consummated and the premises conveyed to the debtor on September 27, 1933, and in pursuance of the plan there were issued and are outstanding $254,450 principal amount of the debtor's debentures, plus $2,350 principal amount unissued, held for the con-

---

* Page references to the Transcript of Record are indicated by the letter "R"; references to the findings of the Referee are indicated by the letter "F". Italics are by counsel unless otherwise stated.

version of $4,700 of the old bonds, or a total of $256,800 principal amount of such debentures authorized (F. 8, R. 70). These are the debentures to which we refer above as to which the petitioner is the trustee.

It should be added that in further pursuance of the plan of reorganization, the debtor at the time of its consummation borrowed the sum of $175,000 from the Poughkeepsie Savings Bank, Poughkeepsie, New York, secured by a first mortgage on the apartment house (F. 10, R. 71).

By early 1942 the debtor was in default under the terms of this mortgage (F. 14, R. 71) and during the years 1942, 1943 and 1944 it was in a precarious condition operating continuously at a loss (F. 12, R. 71). On May 23, 1946 the debtor filed in the United States District Court for the Southern District of New York an arrangement petition under Chapter XI of the Bankruptcy Act (F. 35, R. 74).

This case involves the treatment in those proceedings of the claims of the respondents based upon certain of these debentures (R. 2-3), to which claims the petitioner, both in its capacity as trustee under the debtor's indenture and individually, filed objections (R. 3-9). The petitioner, by its objections, seeks to limit such claims to the amount paid by each of the respondents respectively for their debentures.

The amounts of the respondents' claims as filed and the cost to the respondents of the debentures upon which the claims were based are as follows (R. 2-3; Obj. Exs. 11, 12, 13, R. 62):*

---

* We cannot indicate where the various exhibits were offered in evidence, as required by Rule 27 (3) of this Court, because only extracts from the minutes of the hearing were printed in the Court of Appeals, as provided by its Rule 17 (b), and in none of these extracts is included reference to the introduction of the several exhibits referred to in this brief.

	AMOUNT OF CLAIM	COST
Regine Becker	$44,500.00	$3,060.63
Emily K. Becker	52,800.00	5,010.00
Walter A. Fribourg	50,000.00*	2,124.80

The apartment house had been sold prior to the filing of the arrangement proceeding, so that there resulted a complete liquidation of the debtor and the dividends payable to its creditors amounted to 43.61% of the principal amount of their claims (F. 36, R. 74). Consequently there is involved in this case $54,042.10, being the difference between the dividends on the face amount of the respondents' claims and the cost of the debentures to them.

The Basis of the Petitioner's Objections to the Respondents' Claims

The debentures involved in this case were purchased by the respondents in the years 1942 to 1945 (R. 62) and during all of this period the debtor was found by the Referee to have been insolvent "in that the aggregate of its property was not at a fair valuation sufficient in amount to pay its debts" (F. 55, R. 78).

It is the claim of the petitioner that because the debtor was insolvent during the period when the debentures in question were acquired, neither the directors nor persons, such as the respondents, affiliated with them, related to them or acting in conjunction with them, could profit from any dealings in securities of the debtor and at best may

---

* The claim of the respondent Fribourg as filed was for $55,000. Objection was withdrawn as to $5,000 thereof, costing $480, for reasons which will hereafter appear (F. 38, R. 75).

recover from the estate of the debtor only the amount actually expended by them with interest.

At the time of the acquisition of these debentures two of the directors of the debtor were Sanford Becker and Norman S. Becker who are brothers (F. 18, 20; R. 71-72). The respondent Regine Becker is the mother of these two directors and the respondent Emily K. Becker is the wife of Sanford Becker (F. 27-28, R. 73).

The third respondent, Walter A. Fribourg, was quite close to the Becker brothers. He had known Sanford Becker for many years, both having been connected at one time with the same business (R. 173), and at the time of the transactions at bar Sanford Becker was accountant and secretary of a corporation known as Winsor Buildings, Inc., of which Fribough was president (R. 22-23).* Moreover Fribourg during this period had desk room with the Becker brothers in their office, sharing a room with Norman (R. 21).

It will hereafter be shown that in obtaining control of the debtor and in the acquisition of the debentures here involved the Becker brothers and the three respondents acted in close concert.

The Respondents' Control of the Debtor

The first contact with the debtor by the Becker-Fribourg group (by which term we refer to the Becker brothers and the respondents) was the purchase by Sanford Becker in September, 1941 of $5,000 of these deben-

---

* Sanford Becker testified that he had no financial interest in Winsor Buildings, Inc. (R. 170). Nevertheless he was actively connected with that corporation and not only did work for it and was its secretary but also had power to sign checks on its behalf (R. 170-172). (The exhibits referred to in this part of the testimony are not printed in the Record.)

tures, at which time he acquired also the appurtenant 100 shares of stock (R. 9).* Shortly thereafter in November, 1941 Fribourg purchased $2,000 of the debentures (R. 62). At about this time, in late 1941, because of defaults under the Poughkeepsie Savings Bank mortgage, the debtor had worked out a proposed sale of the property to one Chesterbrook Estates Ltd. for $220,000 (F. 15, R. 71). This sale was opposed by Sanford Becker and Walter A. Fribourg, the former bringing a suit to enjoin it upon the ground that the property had substantially greater value (R. 9-11, 22; F. 16, R. 71).

At a meeting of stockholders held on February 17, 1942 the proposal failed to receive the requisite two-thirds vote of the stockholders and so was defeated (R. 12; F. 17, R. 71). This action of the stockholders was in conjunction with a written offer made by Sanford Becker on behalf of "a client" to cause $15,000 to be loaned to the debtor to meet the mortgage arrears (R. 60-61), tied in with the condition that the lender be permitted to name two directors (R. 14). While the identity of the lender was not disclosed at the time, Sanford Becker testified in this proceeding that "a client" referred to the three respondents (R. 12).**

The $15,000 loan was thereafter made in the name of Baset Realty Corporation (hereinafter sometimes called "Baset") which was organized for this particular trans-

---

* It was stipulated that transactions in the debentures included automatically the appurtenant stock (R. 22).

No objection was filed to Sanford Becker's claim on these debentures because they were purchased prior to his becoming an officer and director of the debtor.

** Mr. Becker's proposal provided that any and all stockholders be permitted to participate in the loan if they so desired. None of them did so, a not unexpected result in view of the fact that it is not disputed that no interest had ever been paid on the debentures.

action and was owned and controlled by the respondents (F. 20, R. 72). Baset later assigned to each of them a one-third participation in the mortgage (R. 13).

The Baset mortgage was closed on April 7, 1942 (R. 14) and at the same time Sanford Becker and Norman S. Becker became directors of the debtor as Baset's nominees, *i.e.*, as the nominees of the respondents (R. 15-16).

The Baset loan also carried the condition that Baset be permitted to designate a new managing agent for the property (R. 60-61) and a new managing agent was thereupon designated by Baset (R. 15-16).

Furthermore, at this same meeting on April 7, 1942 Sanford Becker was elected Treasurer of the debtor and Norman S. Becker, Secretary (R. 16), and it was provided that the principal office of the debtor be moved to the treasurer's office at 11 West 42nd Street, Manhattan, New York City (*i.e.*, the office occupied by Sanford Becker, Norman S. Becker and Walter A. Fribourg) and it appears without dispute that from that time on the office was there maintained (R. 16-17).

It is apparent that as a result of these steps the Beckers had effective control of the situation, for their managing agent was operating the property, they had the books and records of the debtor and the debtor's affairs were conducted from their office. Yet at this time the only securities owned by any of this group were Sanford Becker's $5,000 of debentures and a like amount of debentures owned by Walter A. Fribourg (who had purchased them in November of 1941 and March of 1942) (R. 62.)*

* This $5,000 of debentures purchased by Fribourg are the debentures in that amount which we have previously stated were eliminated from the objections filed to his claim. This was because their purchase antedated the time when the Beckers became directors and the Becker-Fribourg group took over control of the debtor.

In October of 1943, there having been a default under the Baset mortgage, Baset took an assignment of rents (F. 22-23, R. 72) and thereafter the actual physical operations of the property were completely under the control of Baset as mortgagee in possession, functioning through its own managing agent (R. 19).

On June 28, 1944 the three remaining directors (there were five in all) resigned and Sanford Becker's secretary and two friends filled the vacancies, so that from that time on the entire board of directors was completely Becker-Fribourg controlled (R. 17-19). At the same time that the Becker-Fribourg group obtained the whole board of directors, Norman Becker became President of the corporation and has since continued in that capacity (R. 19; F. 52, R. 77).

The Acquisition of Debentures by the Respondents

While the Becker-Fribourg group was obtaining control of the debtor there was also carried out a concerted plan to purchase the debentures which now form the basis of the respondents' claims.

All of the purchases of the respondent Regine Becker were made through an account in the name of Fribourg maintained with one E. Henry Sondheimer & Co. (R. 41-42, 62) and part of the debentures of the respondent Emily K. Becker were acquired in the same fashion (R. 41-42, 66). The respondents Regine Becker and Emily K. Becker exercised no judgment of their own in purchasing their debentures, their purchases having been handled by Sanford Becker as their agent (F. 53, R. 77).

A considerable part of Fribourg's debentures were acquired as a result of a circular letter sent to the other debenture holders in 1944 under the name of his brother-in-law, one Winter, handled through a bank account

opened in Winter's name (R. 31-33, 62). Winter himself testified that he knew nothing of the apartment house in question, had never seen it and did not know anything about the debtor's affairs (R. 48). Moreover, he had no conversation with Fribourg with respect to the transaction (R. 48). He went to the bank with Norman Becker and opened the account upon his introduction and it was Norman Becker who put the money in the bank (R. 48-49). Bank statements and cancelled checks on the account, when received from the bank, were turned over by Winter to Norman Becker (R. 49-50). The mechanics of these maneuvers appear to have been worked out by Sanford Becker (R. 27-31).

These transactions make it clear that the Beckers and Fribourg were acting together, and that the whole operation was a matter of close cooperation and joint action.

Relationship of the Respondents and the Debtor's Directors

There can be no doubt that there was an active relationship between the Beckers and Fribourg, manifesting a complete and understanding concert, and that the Becker brothers, the two Becker ladies and Fribourg were acting as a single group.

As to the Becker ladies the Referee found (F. 53, R. 77):

> "Sanford Becker and Norman Becker acted as agents for the Becker ladies in the purchase of debentures by them. And while Sanford consulted with his mother and wife from time to time as to such purchases, the proof does not warrant a finding that the ladies exercised any discretion of their own in such purchases."

The Referee concluded as a matter of law that the proofs of debt of the Becker ladies "should be treated as

if they were proofs of debt filed by directors of debtor" (Third Conclusion, R. 78).

The District Judge in his opinion expresses no dissent from the Referee's finding (cf. R. 93) and the majority opinion in the Court of Appeals states (R. 185):

> "As respects the Becker ladies, since they exercised no independent judgment in the investment of their funds, they are chargeable with the knowledge of their agent, Sanford Becker."

In his dissenting opinion in the Court of Appeals, Judge Learned Hand said of the Becker ladies (R. 188):

> "They relied altogether upon the directors' advice and exercised no judgment of their own in deciding to buy. In so doing I think that they became charged with the same equities that would have charged the directors, had they bought on their own behalf. In short, the directors could not pass on to their principals profits which they could not have retained for themselves. The principals were charged with notice of what the agents knew, and therefore the principals were not bona fide purchasers."

As to Fribourg, he maintained his office in the suite occupied by Sanford and Norman Becker at 11 West 42nd Street, New York, N. Y. and shared a room there with Norman Becker (R. 21). This incidentally put him in a position to be constantly and fully advised of the debtor's affairs, and as a matter of fact Fribourg reluctantly admitted discussing the debtor's affairs with the Beckers from time to time (R. 23-24).

As we have pointed out, all of Regine Becker's debentures and part of Emily K. Becker's were purchased by Sanford Becker through Fribourg's account with Sond-

heimer, and a substantial part of Fribourg's debentures were purchased through Winter under the supervision of Norman S. Becker. Furthermore Fribourg and the Becker ladies had made substantial advances through Baset to the debtor, and Sanford and Norman Becker as directors were the nominees of Fribourg as well as of the Becker ladies.

While the Referee found as a conclusion of law that Fribourg's proof of debt "should not be treated as if it were a proof of debt filed by a director of debtor" (First Conclusion, R. 78), the District Court said (R. 93) that he was persuaded "that the evidence warrants a finding that the relationship between Fribourg and the Beckers (directors) was of such a nature with respect to the affairs of the debtor so as to treat his proof of debt as a proof of debt of a director".

The majority opinion of the Court of Appeals held that Fribourg did no more than to invest his own funds on a "tip" received from an officer or director of the debtor (R. 185). Judge Learned Hand expressly refrained from discussing the matter (R. 187).

We contend that the claims of all three respondents should be treated as though they were claims of directors of this insolvent debtor.

Lack of Disclosure to the Selling Debenture Holders

The petitioner's objections to the claims of the respondents were based not only on their disqualification to profit in this instance, but also upon the contention that the respondents had acquired the debentures in question by taking advantage of their knowledge as insiders without appropriate and adequate disclosure to the sellers of such securities (R. 7).

The petitioner in support of this contention asserted that the Becker-Fribourg group had failed to reveal to the selling public (1) the very definite prospect that the property could be sold for an amount which would permit of a liquidating dividend substantially in excess of the figure at which the security holders were selling, (2) the identity of Baset with the Becker-Fribourg group, and (3) that insiders were buying the securities.

The Referee overruled this contention (F. 54, R. 77-78). The District Court held that the record did not show that this finding was clearly erroneous (R. 95), a conclusion in which both the majority and minority of the Court of Appeals agreed (R. 182, 186), and consequently, as the matter is factual, the contention is not pressed in this Court.

However, a brief reference to this phase of the case is necessary for a better understanding of the entire situation, and more particularly of certain comments in the two opinions in the Court of Appeals (R. 181-183, 186-187).

Sanford Becker testified that after the $220,000 offer was defeated in 1942, and up to the time of the ultimate sale in early 1946, inquiries with a view to the purchase of the property were received "once a month at least" (R. 20). From the Referee's decision (F. 41, R. 75-76) it is apparent that these inquiries and the offers were in an ever increasing amount, ranging from $240,000 to $280,000. The latter figure was rejected by Norman Becker who stated that he thought $300,000 should be the price (F. 41, R. 75-76), and, as a matter of fact, that is the figure at which the property ultimately was sold (F. 33, R. 74). As a sale at that price resulted in a liquidating dividend of 43.61%, it is perfectly obvious that the other

holders of the debtor's securities would not have sold at prices as low as 3%, had they had any true idea as to the possibilities. Further, had the public had any idea that it was the insiders who were buying the securities, they would have had a like reluctance to part with them.

The respondents upon the trial made no effort whatever to demonstrate that any information with respect to the constant purchaser interest in the property ever was disclosed to the debtor's security holders. It was however contended by the respondents that four of the sellers of securities had knowledge of the situation. The four in question were the King Estate, the Y.W.C.A., Mr. Kelly (the president of the debtor) and Mr. Hays (a director). There is nothing in the record to demonstrate that they were at any time informed of the inquiries and offers being received, nor did the respondents attempt to put any of them on the stand to demonstrate that they did have such knowledge. The only thing which they may have known and which the other public security holders did not know was that the Becker-Fribourg group was purchasing some of the securities.

There is no evidence anywhere in the record that the identity of the Becker-Fribourg group with Baset ever was disclosed and Miles Amend, an attorney who handled the Baset loan for the debtor, testified that to his best recollection there was no such disclosure (R. 45-47).

The Sale of the Property

In October 1945 a contract was made for the sale of the property at a total price of $300,000.00 and title was closed on January 8, 1946. The purchase price was paid by the purchaser taking subject to the then balance of $154,000 on the Poughkeepsie Savings Bank's mortgage, by cash

of $70,000 and by a purchase money mortgage of $76,000 (F. 33, R. 74).

This purchase money mortgage was subsequently sold pursuant to an order of the court for the sum of $66,000 (F. 34, R. 74).

It was in consequence of the sale of the property and the subsequent sale of the purchase money mortgage that sufficient cash was realized to permit of a dividend to the creditors of 43.61% of the principal amount of their claims (F. 36, R. 74).

The Questions Presented

As stated in the petition for certiorari, the questions here presented are whether directors of a corporation may purchase its debt securities while it is insolvent and enforce them in bankruptcy at their full face value rather than be limited to the actual cost; and, if not, whether their relatives and business associates may, in cooperation with these fiduciaries, do what the directors themselves may not do.

The Grounds on which the Decisions of the Courts Below Rested

The Referee, the District Court and the Court of Appeals (L. Hand, Ch. J. dissenting) all overruled the petitioner's objections, but no two of them agreed upon the basis for their conclusions.

The Referee's opinion is printed at pages 79-80 of the Transcript of Record, the opinion of the District Court at pages 91-95, the opinion of the majority of the Court of Appeals at pages 175-186 and the dissenting opinion at pages 186-188.

The Referee took the position that, with certain exceptions not here pertinent, a director, and consequently his associates, may acquire unmatured obligations of the corporation of which he is a director and enforce them for their full face amount, even if at the time he so acquired the obligations the corporation was insolvent. The Referee based his conclusion principally upon this Court's first decision in *Securities and Exchange Commission* v. *Chenery Corp.*, 318 U. S. 80, a case which was not in point, involving as it did the reorganization of a public utility under Sections 6 and 11 of the Public Utility Holding Company Act of 1935, where the subject company was not insolvent but was being reorganized in order to divest itself of certain subsidiary companies in accordance with the provisions of that statute.

In the District Court, Judge Goddard held that cases condemning transactions by directors in the debt securities of an insolvent corporation did not cover the situation where the corporation, although insolvent in a bankruptcy sense, is still a "going concern", applying what he deemed to be the rule as laid down in decisions of the New York courts (R. 94).

The prevailing opinion of the Court of Appeals was written by Swan, C. J., Chase, C. J. concurring. The dissenting opinion was written by Learned Hand, Ch. J.

The majority took the position that the matter was not governed by decisions of the New York courts since the bankruptcy law, including what the federal judges think to be equitable, determines what dividends shall be distributable to a claimant (R. 176-177); that the wrong, if any, had been done to those who had sold their claims at a price less than the dividend they would have received had they retained them (R. 184); that where, as here,

the contest is between the unwronged cestuis (i. e., the debtor's other creditors) and the directors, if the former are to prevail it can be only as a disciplinary measure (R. 184); that if the doctrine be recognized as a disciplinary sanction within the discretion of the court to impose or withhold, then each case should depend on its own circumstance, and consequently in the case at bar, where there was no overreaching of the sellers, the majority was not convinced that the circumstances were such as to require the imposition of the sanction, even if the proofs of debt had been filed by directors of the debtor themselves (R. 184-185).

The majority stated further that these particular respondents were not directors or officers of the debtor, that their own funds were invested, and that no officer or director of the debtor had any interest in the debentures purchased; that as to the Becker ladies, while they exercised no independent judgment and are chargeable with the knowledge of their agent, Sanford Becker, there was no overreaching of the sellers; and that as to the respondent Fribourg, there was nothing in the record to justify a finding that he did more than invest his own funds on a "tip" received from an officer or director of the debtor (R. 185-186).

Judge Learned Hand in dissenting took the position that if equity regards the bonds as improperly acquired it is more nearly just to distribute any profits among the other creditors, who have not been paid in full, than to leave them in the directors' hands (R. 186); that no fiduciary deals with his beneficiary on terms of equal advantage, and that if he is to avoid that restriction he must be able to point to some circumstance which will excuse him (R. 187); that there was a distinction to be

taken between purchasers of stock and purchasers of debt securities (R. 187); that before accepting the excuse in the case of debts the burden should be put on the director of proving not only that he genuinely expected by a composition to continue the business but that his expectation was well founded, and that nothing short of both would serve as an excuse, and that neither was proved in the case at bar (R. 188).

As to the Becker ladies, Judge Hand felt that they were chargeable with what their agents knew and were not bona fide purchasers (R. 188). As to Fribourg, Judge Hand stated that the correct answer was not altogether clear but it would have been necessary to find it only in case the majority had agreed with his disposition of the chief issue (R. 188).

Summary of Argument

I

Directors of a corporation may not purchase its debt securities while the corporation is insolvent and enforce them in bankruptcy at their full face value, but are limited to the actual cost of such securities and interest.

> As a matter of principle directors should not be permitted to enforce at face value debt securities of their corporation purchased when the corporation is insolvent.
>
> Previous Federal decisions on this subject have uniformly followed this principle.
>
> Other authorities are to like effect.
>
> That such a result will not make whole those from whom the securities are purchased, but rather

will inure to the advantage of the estate and, therefore, to the non-selling debenture holders, is beside the point. Likewise it is of no consequence that no harm was done to the debtor.

The Referee and the District Court erroneously relied upon certain New York decisions, which are neither in point nor authoritative in a bankruptcy proceeding.

The Referee misapprehended this Court's decision in *Securities and Exchange Commission* v. *Chenery*, 318 U. S. 80.

The District Court erroneously applied a so-called "going concern" theory.

II

As the directors themselves were disqualied to purchase the debt securities of their insolvent corporation, such persons as these respondents, related to them, affiliated with them or acting in conjunction with them, likewise cannot profit from any dealings in such securities.

ARGUMENT

I

Directors of a corporation may not purchase its debt securities while the corporation is insolvent and enforce them in bankruptcy at their full face value, but are limited to the actual cost of such securities and interest.

We first discuss the problem at bar upon the assumed hypothesis that the purchases in question were made by directors themselves. We do this because, if directors

may make such purchases with impunity, we do not reach the problem of the treatment to be afforded these respondents.

As a matter of principle directors should not be permitted to enforce at face value debt securities of their corporation purchased when the corporation is insolvent.

It is not disputed that during all the period when the respondents purchased the debentures here involved the debtor was insolvent in the bankruptcy sense (cf. F. 55, R. 78).

That the debtor was insolvent also in the equity sense is manifest not only from the Referee's finding that during the years 1942, 1943 and 1944, when most of the debentures were acquired,* it was in a precarious condition operating continually at a loss (F. 12, R. 71) but also from the chart introduced by the respondents (Resp. Ex. 17, R. 68) which shows that this condition continued throughout the year 1945.

Finally it is not disputed that the respondents' debentures, aggregating in face amount $147,300.00, were acquired for a total purchase price of $10,195.43.

It is elementary that directors undertake a fiduciary obligation, of which this Court said in *Pepper* v. *Litton*, 308 U. S. 295, 307 (1939):

> "For that standard of fiduciary obligation is designed for the protection of the entire community of interests in the corporation-creditors as well as stockholders."

Manifestly, the fiduciary obligation of directors is the greater when his corporation is insolvent and when its

---

* See statement of purchases, R. 62.

financial affairs are precarious. Whatever may be the extent of the director's obligations when the corporation is conducting its business in ordinary fashion, the impact of insolvency throws upon the director the urgent duty of considering what steps are to be taken to protect the best interests of his corporation, its stockholders and its creditors.

The Securities and Exchange Commission, in a brief as *amicus curiae* in the Court of Appeals, wrote in support of the petitioner's position as follows:

> "In our opinion the district court failed to appreciate the significance of the state of insolvency, irrespective of the pendency or imminence of the bankruptcy proceeding, and of the effect of insolvency upon the duties of directors and their relationship to the corporation, its creditors and stockholders. Insolvency by its very nature places the corporation in the field to settle its indebtedness. From that point on, any purchase of debt securities by a director is fraught with potential conflicts of interest. The directors of the corporation, at least in the absence of action by creditors, must determine whether or not to institute a statutory proceeding such as filing a voluntary petition under the Bankruptcy Act. They may decide to undertake direct negotiations with the corporation's creditors for adjustment of its debt, possibly in connection with efforts to seek fresh capital. In any event, the determination of what should be done, and when, is for the directors to make in the best interests of the corporation."

The majority of the Court of Appeals could see no reason why there should be a difference between the director's position when his corporation is solvent and when it is insolvent, saying (R. 183):

> "It is not immediately apparent why insolvency should make a difference. It will cost the debtor no more whether the dividend which it may be able to pay creditors goes to the original holder of the debt or to a director-assignee."

Once liquidation occurs the identity of the creditor may, to be sure, be immaterial, but the conduct of directors, who are buying an insolvent corporation's debt securities at depressed prices, may make a substantial difference one way or the other to the corporation and its creditors. What is to prevent directors from taking a certain line of action, or none at all, until they have corralled all of the debt securities they can? The directors of an insolvent corporation, faced with all the problems that insolvency creates, must keep themselves in a position where there will be no conflict of interest between their position as creditors and the welfare of the entire community of interests in the corporation. Claims which directors may have acquired when the corporation was solvent may, of course, present some conflict of interest once the corporation has become insolvent; but where after insolvency has occurred directors make purchases of claims they are deliberately creating the conflict. Having done so, directors should not be permitted to profit, and such has been the uniform rule in the federal courts until the decisions below in the instant case.

Judge Learned Hand pointed this out in his dissenting opinion below where he said (R. 187):

> "The claimants in the case at bar argue that, since directors may freely buy shares in the market, they must be equally free to buy debts from creditors after insolvency, when, as I have just said,

creditors step into the place of shareholders. That there is at least a prevailing belief in the federal courts to the contrary, the decisions discussed in my brothers' opinion make clear; they form a substantial body of opinion, which *Securities and Exchange Commission* v. *Chenery** did not disturb."

Previous Federal decisions on this subject have uniformly followed this principle.

The question has been considered by the Courts of Appeal for the Sixth, Seventh and Tenth Circuits and in every instance the purchasing directors were limited to the amount paid by them for their claims. In none of these cases was it deemed material whether or not bankruptcy proceedings had already begun. As a matter of fact in one case the reorganization proceedings did not commence until a year after the transaction, in another the corporation was in state receivership but not in bankruptcy, and in the third bankruptcy proceedings had begun when the claim was acquired. Moreover, in the first two of these cases certiorari was denied by this Court.

These three cases are *In Re Van Sweringen Company*, 119 F. 2d 231 (6 Cir. 1941; cert. den. *sub nom. Terminal & Shaker Heights Realty Co.* v. *Van Sweringen Company*, 314 U. S. 671); *In Re Norcor Manufacturing Co.*, 109 F. 2d 407 (7 Cir. 1940; cert. den. 310 U. S. 625); *Monroe* v. *Scofield*, 135 F. 2d 725 (10 Cir. 1943). We will discuss them in that order.

In Re Van Sweringen Company.—There the Vaness Company was the majority stockholder of two debtor companies, one of which in turn owned all the stock of the Cleveland Terminal Building Company, another of the

---

* 318 U. S. 80

debtors. The Van Sweringen brothers were officers and directors of all these companies. In May, 1930, the Vaness and Cleveland companies borrowed $39,500,000 from J. P. Morgan & Company evidenced by notes and secured by certain collateral securities. Upon default on the notes in May, 1935, the collateral securities were to be sold at public auction in September. In August of the same year, the Van Sweringens formed the Midamerica Corporation whose successor was the claimant in the proceeding. The agreement setting up this corporation provided that one Ball and one Tomlinson would put up $2,000,000 and the Van Sweringens would have an irrevocable option to purchase 55% of the common stock for a period of 10 years and obtain control of the board of directors. At the auction sale Midamerica bought in the notes of the debtor together with the collateral securities which were conceded to have a value greater than the total amount paid. The notes of the three debtors purchased were carried on Midamerica books at $1, $2 and $887, respectively. The claimant sought in the debtors' reorganizations to enforce a claim on these notes at their total face value of $39,500,000.

That the reorganizations of these debtors did not commence until somewhat over a year later, *i.e.*, October 19, 1936, does not appear in the opinion, apparently because the court did not regard the pendency of reorganization proceedings as a material factor. We obtain the date of the commencement of these proceedings from *Gochenour v. Cleveland Terminals Bldg. Co.*, 142 F. 2d 991, 992 (6 Cir. 1944).

The court held that the claims were to be limited to $1, $2 and $887 plus interest from the date of acquisition, saying at page 234:

"From the manner and under the circumstances in which, in association with outside enterprisors, the Van Sweringens, as directors of insolvent corporations, purchased these claims against their cestui que trustent, the debtors, herein, at substantially less than real values, equity and good conscience demand that the claims of their corporate creature, Midamerica (predecessor to appellant), be limited to the amounts actually paid by it for the notes and bonds of the insolvent corporations. (*Citing cases.*)

As expressed by Chief Judge Cardozo in Meinhard *v.* Salmon, 249 N. Y. 458, 464, 164 N. E. 545, 546, 62 A.L.R. 1: 'Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions. * * * Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court.' We uphold the standard of this doctrine."

In Re Norcor Manufacturing Co.—There one Krueger was the principal stockholder and director of the Norcor Manufacturing Co., the debtor, which had confessed insolvency in a state court. Ten months later Krueger hired an attorney, one Lehner, for the purpose of reorganizing the debtor. Lehner was furnished with a list of stockholders, financial statements and other pertinent

data and he then solicited creditors of the debtor, offering to purchase their claims at 10 to 30% of their face value. Krueger assigned his controlling stock to a third person who reassigned the same to the Norcor Company, a new corporation whose board of directors was controlled by Krueger and Lehner. Lehner continued to offer to purchase such claims and assignments of such claims were made to Lehner, his wife, Krueger and Krueger's son, all of whom reassigned such claims to the new corporation. These claims totaled $65,016.73, for which amount the new company made a claim in the debtor's reorganization. The actual amount paid for such claims was $13,331.13.

The court limited the claims to the amount actually paid for them, saying (p. 411):

> "It is argued that Krueger and his attorney Lehner sustained such a fiduciary relation with the debtor corporation as would preclude them from purchasing claims of creditors at a small fraction of their face value, and using them as the foundation for a claim in excess of that actually paid therefor. We think this argument is sound. Certainly Krueger, as Managing Director, occupied such position."

The court then quotes from this Court's opinion in *Pepper v. Litton, supra,* and continues:

> "As Krueger occupied a fiduciary relation, so did his attorney Lehner. Neither of them would have been entitled to the allowance of a claim in an amount which would have inured to his individual profit. Being thus precluded as individuals, they had no right to accomplish the same purpose under the guise of a corporate entity."

Monroe v. *Scofield*.—There a director purchased a judgment against his corporation after the commencement of bankruptcy proceedings against it. The court limited the claim to the amount paid, saying (p. 728):

> "Where a corporation is a going concern, a director may purchase a claim against the corporation at a discount and enforce it for the full amount, absent a present duty on his part to act for the corporation. However, where the corporation is insolvent, he is precluded from recovering more than he paid for the claim unless by an order of the court or otherwise he has been shorn of all power in the corporate management and his trust relationship has been fully terminated."

We know of no decisions in any federal Court of Appeals contrary to the result reached in the foregoing three cases except the case at bar. Here the majority of the Court of Appeals held that the application of the rule could only be as a disciplinary measure for wronging someone (the sellers) who had not complained of the wrong and concluded that as there was no overreaching of the sellers it was not convinced that the circumstances were such as to require imposition of the sanction, "even if the proof of debt had been filed by a director of the debtor" (R. 184-185).

This is an entirely new and startling conception, which ignores this Court's statement in *Pepper* v. *Litton*, *supra*, that the standard of fiduciary obligation is designed "for the protection of the entire community of interests in the corporation". The court below was not oblivious of the contention that insolvency creates a conflict between duty and the personal interests of the directors (cf. R. 183) but nevertheless expressly held the test to be one of "over-reaching of the sellers".

The criterion of insolvency, as adopted in the three decisions of the Courts of Appeal above discussed, has also been the criterion which has been uniformly adopted by the District Courts.

The most complete discussion of this subject in the District Courts appears in *In Re Los Angeles Lumber Products Co. Ltd.*, 46 F. Supp. 77 (D.C., S.D., Cal., 1941),* and because the case is so apposite in its facts we refer to it at some length.

There one Faries had represented certain holders of the debtor's bonds and was secretary and counsel of an informal bondholders' committee. An immediate reorganization of the debtor company was contemplated but at the time no such proceedings were pending. Faries was elected a director and vice-president and appointed general counsel for the debtor in June, 1936, which positions he occupied until after confirmation of the plan in 1940.

Until July, 1937, as part of the contemplated reorganization, Faries had purchased bonds for the account of the debtor with funds supplied by one of its subsidiaries. In July, 1937, these funds ran out and Faries then and prior to December, 1937, purchased $14,500 principal amount of bonds for $1,512.10 with the intention of delivering them to the debtor if it should have other funds, a contingency which never occurred. A petition for reorganization was filed on January 28, 1938.

During the pendency of the reorganization proceedings Faries purchased other bonds of the debtor alone and in conjunction with a brokerage firm (District Bond Com-

* This opinion was rendered subsequently to the decision of this Court in *Case* v. *Los Angeles Lumber Products Co., Ltd.*, 308 U. S. 106 (1939).

pany), some of such purchases being made from the president of the company and associates of his. Also the brokerage firm solicited bonds from some of the sellers by the use of post-cards and by this means some purchases were made without revealing the identity of the purchasers.

After confirmation of the plan a bondholders' committee moved to cancel or reduce Faries' and District Bond's claims on the bonds referred to above.

The court (Jenney, J.) held that Faries as a director, officer and counsel was a fiduciary and could make no profit on securities of the debtor while acting in that capacity and that District Bond, having full knowledge of Faries' position, would be treated in the same manner. Accordingly, the claims of Faries and District Bond were limited to what they had paid for the bonds plus six percent interest from the date of acquisition.

The factual similarities between the *Los Angeles Lumber Products Co.* case and the instant case are striking.

When Faries purchased the first of the bonds which he retained for himself, there was no competition with the debtor for the debtor's funds had been exhausted. Even though Faries made these purchases with the intention of delivering them to the debtor if it should acquire other available funds, yet his recovery thereon was limited by the court.

Moreover, the early purchases were made before any reorganization proceedings were pending.

In both cases some securities were purchased in the open market.

In the instant case Fribourg made purchases from the president and another director of the debtor; in the *Los*

Angeles Lumber case Faries made purchases directly from the secretary to the company's president, and also made purchases in conjunction with District Bond Company from the president himself and associates of the president. The District Bond Company was cognizant of Faries position in the matter (as were the respondents of the situation in the instant case) and therefore was held disqualified.

There is one striking dissimilarity, which is that, whereas in the instant case every effort was made to minimize the debtor's prospects, in the *Los Angeles Lumber* case Faries from the beginning advised everyone who inquired not to sell their bonds.

The opinion in the *Los Angeles Lumber* case contains a very complete citation of authorities. The opinion is quite long and we quote merely the following (p. 88):

> "From these references it will be seen that the rules laid down by the courts are designed 'to provide against any possible selfish interest exercising an influence which can interfere with the faithful discharge of duty which is owing in a fiduciary capacity' (Magruder v. Drury, 235 U. S. 106, 119, 35 S. Ct. 77, 82, 59 L. Ed. 151) and these rules have long been strictly enforced (Michoud v. Girod, 45 U. S. 503, 4 How. 503, 557, 11 L. Ed. 1076), and they are required 'because of the demonstrated fallibility of mankind'. (Loring, A Trustee's Handbook, Shattuck Revision, p. 66.)
>
> It has, of course, long been established that officers, directors and attorneys of a corporation are fiduciaries and that they should be held responsible for any breach of duties as such. *They may not, while the corporation is insolvent, purchase claims against it at a discount and then enforce such claims at their full face value.* Bonney

v. Tilley, 1895, 109 Cal. 346, 42 P. 439; Davis v. Rock Creek Lumber, etc., Co., 1880, 55 Cal. 359, 36 Am. Rep. 40. When the corporation is not only insolvent but has filed its petition under Section 77B or Chapter X of the National Bankruptcy Act as amended, 11 U.S.C.A. §501 et seq., and the directors have become trustees of the debtor in possession, the directors' obligations as trustees become even more rigorous. In re Norcor Mfg. Co., 7 Cir., 109 F. 2d 407; Pepper v. Litton, 308 U. S. 295, 60 S. Ct. 238, 84 L. Ed. 281.

The good faith or innocent motives of the fiduciary, or his well-intentioned purpose to effectuate a plan of reorganization, constitute no defense to liabilities founded upon breaches of fiduciary obligations. In re McCrory Stores Corp., D.C. S.D. N.Y., 1935, 12 F. Supp. 267, 269, 30 Am. Bankr. Rep., N. S., 670.

* * * * * * *

And it is likewise no defense to say that fraud was not intended and that unfairness did not result from the trustee's actions Magruder v. Drury, 235 U. S. 106, 120, 35 S. Ct. 77, 59 L. Ed. 151; Jackson v. Smith, 254 U. S. 586, 589, 41 S. Ct. 200, 65 L. Ed. 418; Tomblin v. Hill, 206 Cal. 689, 275 P. 941. Actual fraud in such cases is not necessary to give the client redress. A breach of duty is constructive fraud. Baker v. Humphrey, 101 U. S. 494, 25 L. Ed. 1065. There are many situations, in which a constructive trust is imposed even in the absence of fraud. 3 Scott on Trusts, §462."

In *In Re Jersey Materials Co.*, 50 Fed. Supp. 428 (D.C., N.J., 1943), the debtor was organized by one Schweyer and one Krohn in 1933. At that time it purchased its property, making part payment therefor by a real estate mortgage in the sum of $3,500. This mortgage was not

paid at maturity in 1936 and by 1941 "the affairs of the bankrupt were in a precarious state". However, the debtor concluded an agreement with the owners of the mortgage which provided *inter alia* that they would take preferred stock in place of the mortgage. This agreement was never consummated and in October, 1941 one Connor purchased the mortgage for $1,600 and spent in incidental expenses an extra $100. On February 16, 1942 an involuntary petition in bankruptcy was filed against the debtor and it was adjudicated a bankrupt in March, 1942.

The underlying facts in connection with Connor's acquisition of the mortgage were that the owners thereof informed Schweyer that they would sell the same at a discount and Schweyer, having been advised by his attorney that he could not legally acquire the same himself since he was a director, urged Connor to make the purchase which the latter did with money loaned to him by Schweyer. Connor was at all times cognizant of the position of Schweyer and of the finances of the debtor. Connor sought to enforce in the bankruptcy proceedings the mortgage at its face value while the trustee in bankruptcy sought to limit his claim to the amount paid by him for the mortgage.

The court (Forman, J.) held that Connor's claim would be limited to the amount which he had paid for the mortgage, namely, $1,700.

In the *Jersey Materials* case, as with the debentures in the instant case, the acquisition of the mortgage occurred prior to any bankruptcy proceeding, but at a time when the finances of the corporation, to use the language of the court in that case, "were in a precarious state", which is almost the precise language used by Referee Olney to describe the situation of the instant debtor (F. 12; R. 71).

In Re Philadelphia & Western Ry. Co., 64 F. Supp. 738 (D.C., E.D., Pa., 1946) involved purchases by directors of a corporation in reorganization under former Section 77B of the Bankruptcy Act where no trustee was appointed, the debtor having continued in possession under management of directors approved by the court. During the reorganization period certain of these directors and others standing in various relations to them purchased bonds of the debtor. While this presents an extreme case the opinion of the court (Kirkpatrick, J.) is illustrative of the decisions of the Federal Court on the general subject.

After pointing out that directors of a solvent corporation may purchase its debt securities at a discount and enforce them for their full amount, the court went on to say (p. 740):

> "If, however, the corporation becomes insolvent, the duties and obligations of the quasi-trusteeship become more closely assimilated to those of regular trustees. This may be partly due to the influence of the frequently repeated generalization that the assets of an insolvent corporation are a trust fund for the benefit of the creditors, and partly to the fact that, when the corporation is insolvent, ownership of its obligations, particularly its mortgage bonds, comes very close to being the full equivalent of ownership of its assets. At any rate, courts of equity, administering the affairs of such corporations, have set a standard of conduct stricter than that 'permissible in a workaday world', Meinhard *v.* Salmon, infra. When bankruptcy follows insolvency and the debtor is left in possession without the intervention of a trustee, the directors, holding office under Court appointment or Court approval, become in all respects, so far as their

fiduciary obligations are concerned, the full equivalent of a trustee in bankruptcy. In re Los Angeles Lumber Products Co., D.C., 46 F. Supp. 77; In re Cheney Bros., D.C., 12 F. Supp. 605; In re James Butler Grocery Co., D.C., 12 F. Supp. 851. As such, they may not traffic, to their own profit, in either the assets or the obligations of the debtor. In re McCrory Stores Corp., D.C., 12 F. Supp. 267; Monroe v. Scofield, 10 Cir., 135 F. 2d 725."

In *In Re McCrory Stores Corporation*, 12 F. Supp. 267 (D.C., S.D., N.Y., 1935), the issue involved was as to the fairness of a plan of reorganization. The plan provided *inter alia* that United Stores Corporation was to receive, for certain landlord claims purchased by it, common stock at $5.40 per share to the amount of the cost of such claims to it plus incidental expenses. At the same time such common stock was to be subscribed for by the old common stockholders at $6.50 per share which all parties had agreed was a fair value.

United sought to justify its receipt of new common stock at $5.40 a share upon the ground that the claims had a provable value of $7,000,000 in lieu of which they were taking stock up to the amount of its actual cost plus expenses in an amount of $3,130,966.

United had acquired the landlord claims in the following manner. After buying debentures and preferred stock in the open market it enlisted one Hedden's aid to acquire for it such claims which were widely scattered. Hedden, after doing some groundwork towards the corralling of the claims, became a director of McCrory for a short period, during which time he obtained information with reference to what the debtor had accomplished with respect to the claims. Upon his resignation from the board of directors

he was able to purchase all the landlord claims for cash, which claims he then turned over to United.

The court (Patterson, J.) held that the plan was unfair in that it unfairly discriminated in favor of United, and rejected United's argument that its landlord claims were actually being taken at less than their value, saying at page 269:

> "The inference is a fair one that the information relative to settlements which he had obtained while a director was of value to him in acquiring the claims for the United; how much value I cannot say. * * * Under ordinary conditions a director may purchase claims against his corporation at a discount and enforce them for their full amount. Seymour *v.* Spring Forest Cemetery Association, 144 N. Y. 333, 39 N. E. 365, 26 L.R.A. 859; Glenwood Mfg. Co. *v.* Syme, 109 Wis. 355, 85 N. W. 432; Fletcher on Corporation, §2289. But the case is different where the corporation is insolvent and is itself in the field to settle the claims. A director who acquires claims under such circumstances may enforce them for no more than the cost of acquisition. Hedden then was inhibited from making a profit by acquiring claims against the debtor at a discount straightway after resignation and enforcing them at a greater amount. The United is under a like inhibition and must be deemed to hold the claims in trust for the debtor. It may enforce them for no more than it paid the landlords for them together with a reasonable allowance for the expense involved in acquiring them. A constructive trustee is entitled to his necessary expenses within reasonable bounds. Ludington *v.* Patton, 111 Wis. 208, 86 N. W. 571. See, also, Loos *v.* Wilkinson, 113 N. Y. 485, 500, 21 N. E. 392, 4 L.R.A. 353, 10 Am. St. Rep. 495; Wolcott *v.* Commercial Investment Trust, 7 F. Supp. 809, 812 (D.C. N.Y.)."

Ripperger v. *Allyn et al.*, 25 F. Supp. 554 (D.C., S.D., N.Y., 1938), was cited both by the Referee (R. 79) and the District Court (R. 94) as opposed to the foregoing holdings, apparently because of the following dictum in the opinion (p. 555):

> "Directors and those who occupy a similar relation to a corporation may buy up claims held by strangers against it or may purchase from others liens on corporate property without accountability for profits, when the transaction is fair to the corporation and involves no competition with it. The prohibition applicable to strict trustees does not cover such a case."

It does not appear that the corporation there was insolvent nor did the case itself have anything to do with the problem here involved.

The underlying philosophy of the cases we have referred to is to the effect that once a corporation becomes insolvent there arises a situation which so alters the position of its directors as to preclude them from creating any possible conflict of interest with the corporation, its creditors and stockholders and which so disqualifies them from purchasing the corporation's debt securities as to exclude them in a bankruptcy proceeding from receiving more for the securities than they paid for them.

Other authorities are to like effect.

The result for which we contend is recognized by text writers. For example, *Remington on Bankruptcy,* Volume 2, §975.01, at page 69, 1948 Supplement, says:

> "Officers and directors may not while the corporation is insolvent purchase claims against it at a discount and then enforce such claims at their full

face value. The good faith of the fiduciary or his well intended purpose will be no defense. Actual fraud is not necessary. A breach of duty is a constructive fraud."

In Fletcher's Cyclopedia of the Law of Corporations, Volume 3 (1947 Repl. Vol.) it is stated (p. 247):

> "The general rule now seems to be that officers, directors and attorneys of a corporation may not, while the corporation is insolvent, purchase claims against it at a discount and then enforce such claims at their full face value."

The Court's attention is also called to *Bulkley* v. *Whitcomb*, 121 N. Y. 107 (1890), *Bramblet* v. *Commonwealth & Lumber Co.*, 26 Ky. L. Rep. 1176, 83 S. W. 599, 602 (1904); and to *Bonney* v. *Tilley*, 109 Cal. 346, 42 P. 439 (1895).

> ***That such a result will not make whole those from whom the securities are purchased, but rather will inure to the advantage of the estate and, therefore, to the non-selling debenture holders, is beside the point. Likewise it is of no consequence that no harm was done to the debtor.***

Given improper conduct on the part of fiduciaries, the question is whether they shall be allowed to retain the fruits of their breach of trust or be deprived of them. As we have seen, the federal courts have consistently made deprivation the penalty.

This is not a novel doctrine. In *Magruder* v. *Drury*, 235 U. S. 106 (1914), the executors under a will were deprived of their commissions for conducting transactions with themselves. Pointing out that the estate was not a loser in these transactions, this Court nevertheless went on to say (p. 120):

"While no wrong was intended, and none was in fact done to the estate, we think nevertheless that upon the principles governing the duty of a trustee, the contention that this profit could not be taken by Mr. Drury owing to his relation to the estate, should have been sustained."

Similarly in *In Re Real Estate Mortgage Guaranty Co.*, 55 F. Supp. 749 (D.C., E.D., Pa., 1944), Judge Kirkpatrick discussed the question of whether an equity receiver should be deprived of his compensation for self-dealing and made the comment (p. 752):

"The doctrine that a receiver may not retain a personal profit made out of his trust is a prophylactic rule. It implements the law's precept that a trustee must give undivided loyalty to his trust. The surcharge is the sanction."

Like language is found in Judge Kirkpatrick's decision in *In Re Philadelphia & Western Ry. Co., supra,* where the court said (p. 740):

"The rule is one of policy and is in general the same as that laid down by the Supreme Court in Magruder *v.* Drury, 235 U. S. 106, 35 S. Ct. 77, 82, 59 L. Ed. 151, 'It is a well-settled rule that a trustee can make no profit out of his trust. * * * It makes no difference that the estate was not a loser in the transaction * * *. It is the relation of the trustee to the estate which prevents his dealing in such way as to make a personal profit for himself.' It is proper to say of the respondents in this case that no wrong was intended and none was, in fact, done to the debtor, but that is precisely what the Supreme Court said of the defendant in the Magruder case, supra. If a trustee may use his positon and the inside information which

he has acquired to his own advantage in cases where there is no conflict with the interests of his cestui que trust, the temptation will always be present to do so in cases where there is such conflict. That is the basis of the rule and it applies in this case although there is no charge, no evidence and no suggestion of fraud, overreaching or of any harm to the debtor."

Judge Hand in his dissenting opinion below (R. 186) put the thought as follows:

"I can see no apparent anomaly in distributing the profits on a director's purchase among the creditors at large, when they cannot be returned to the seller. However, it appears to me an excuse for doing so that, if equity regards the bonds as improperly acquired, it is more nearly just to distribute any profits among the other creditors, who have not been paid in full, than to leave them in the director's hands; for they are a part of the bankrupt's assets and the creditors have a better claim to them than the director himself."

In other words the reason for the rule of deprivation of profits in the case of a wrong doing fiduciary is not to enrich the estate but to punish the fiduciary, and such was the result in all of the cases which we have discussed.

For this reason it is immaterial that certain of the sellers of the debentures were Mr. Kelly (the president of the debtor), Mr. Hays (a director) and the King Estate and the Y. W. C. A. (who had kept in contact with the affairs of the corporation). As we have pointed out, there is no evidence as to just what information these four sellers had, nor does it make any difference in view of the principal which has heretofore been uniformly adopted by the federal courts.

As a matter of fact this precise situation was presented in *In Re Los Angles Lumber Products Co., Ltd., supra,* where the director, Faries, purchased some of the bonds in question from the secretary to the president (46 F. Supp. at p. 82) and in conjunction with the brokerage firm made additional purchases from the president and associates of the president (p. 83). No distinction was made by the court between those bonds and bonds purchased from the public at large.

No suggestion was made in either the opinion of the Referee (R. 79-80) or the opinion of Judge Goddard (R. 91-95) that these particular sellers stood in any different position than the other sellers. It was only in the Court of Appeals that such a distinction was made and that was due to the circumstance that the majority felt that it was necessary to demonstrate an over-reaching of the sellers in order to require the imposition of the sanction (R. 184-185)*. If the principle is to have such an exception, it will be necessary to scrutinize each particular purchase by a director, with the practical result that the efficacy of the rule will be destroyed.

It may be that here, as in the courts below, the respondents will argue that the activities of the Becker-Fribourg group, in lending money to the debtor and keeping it alive through its difficult last years until a satisfactory sales price was received, were beneficial to the debtor and that therefore they should not be penalized. Such a contention was rejected by Judge Patterson in *In Re McCrory Stores Corporation, supra,* where he said (p. 269):

> "It is true that if some one with money had not appeared on the scene and reduced the scattered

* Judge Learned Hand in dissenting seems to have followed the majority in making the distinction (R. 188).

claims of landlords to a single control, reorganization of the debtor would have been a most difficult task. It is also true that the present plan of reorganization is vastly more favorable to creditors and stockholders than the plan to which the debtor was then committed under its contract with the Chicago group. It may well be that the creditors and stockholders are better off because of the United's activities in the situation. These matters, however, have no legal significance."

The same thought is expressed in *In Re Los Angeles Lumber Products Co., Ltd., supra,* 46 F. Supp. at page 88, where incidentally the court quotes the foregoing language from the *McCrory* case.

The Referee and the District Court erroneously relied upon certain New York decisions, which are neither in point nor authoritative in a bankruptcy proceeding.

The Referee held (R. 79) that a director may acquire for himself unmatured obligations of his insolvent corporation and enforce them for their full face amount, provided that the debtor has not provided any special fund to pay such obligations, that no special liquidation had been ordered, that the debtor was not in the field to settle its obligations, that their acquisition was not unfair to the debtor and that there was no over-reaching.

In support of this holding the Referee cited three New York cases (R. 79) *Seymour* v. *Spring Forest Cemetery Ass'n., et al.,* 144 N. Y. 333; *Claire Neon Lights, Inc.* v. *Federal Electric Co. Inc.,* 250 App. Div. N. Y. 510, 517; and *Hauben* v. *Morris,* 255 App. Div. N. Y. 35, 46, aff'd. 281 N. Y. 652. In none of these cases, however, did it appear that the corporation was insolvent. The Referee

did not cite *Bulkley* v. *Whitcomb*, 121 N. Y. 107 (1890), where the court said (p. 111):

> "As a director of the company, owing to it the duty of acting in its interest and for its benefit, he could not buy up its outstanding debts for his own benefit, *knowing it to be insolvent*, and intending thus to get an advantage over other creditors, and hold the debts purchased for their full amount."

However, New York decisions, even if to the contrary, would not govern since, as the Court of Appeals held in this case (R. 176-177), federal law controls the distribution to creditors in bankruptcy. The court cited *Prudence Realization Corp.* v. *Geist*, 316 U. S. 89; *American Surety Co.* v. *Sampsell*, 327 U. S. 269, 272; *Heiser* v. *Woodruff*, 327 U. S. 726, 732; *Vanston Committee* v. *Green*, 329 U. S. 156, 161-163.

Judge Goddard, in addition to the cases relied upon by the Referee, also cited *Moore Construction Co.* v. *U. S. Fidelity & Guarantee Co.*, 293 N. Y. 119; *Inglehart* v. *Thousand Islands Hotel*, 32 Hun 377 and *Oelbermann* v. *N. Y. & Northern R. Co.*, 14 Misc. 131 (R. 94).

These cases likewise did not involve insolvent corporations and in any event were not applicable because, as we have stated, this is a matter of federal bankruptcy law.

The Referee misapprehended this Court's decision in Securities and Exchange Commission v. Chenery.

The Referee also held (R. 80) that the decision in *In Re Los Angeles Lumber Products Co. Ltd., supra*, could not be taken as an authority, being at variance with this Court's decision in *Securities and Exchange Commission* v. *Chenery*, 318 U. S. 80.

The *Chenery* case involved the reorganization of a public utility under Sections 6 and 11 of the Public Utility Holding Company Act of 1935. The subject company *was not insolvent* but was being reorganized in order to divest itself of certain subsidiary companies in accordance with the provisions of that statute.

The Securities and Exchange Commission had approved a plan of reorganization only after having insisted that the plan be amended to provide that the directors of the old company, who had purchased a sufficient number of its preferred shares to give them control of the reorganized company, should receive in exchange for such preferred shares only the cost of such shares in lieu of shares in the reorganized company. On appeal the Court of Appeals for the District of Columbia held that the directors' preferred stock was entitled to share ratably with the other preferred shares. This Court, in turn, reversed the Court of Appeals and remanded the matter to the Commission. In doing so this Court pointed out that the Commission had reached its result on what it conceived to be broad equitable principles. The court went on to say (p. 88):

> "As the Commission concedes here, the courts do not impose upon officers and directors of a corporation any fiduciary duty to its stockholders which precludes them, merely because they are officers and directors, from buying and selling the corporation's stock."

However, in remanding this Court stated that it felt such a limitation on directors might be within the rule making power of the Commission as an administrative agency under the statute.

The Commission having again reached the same result, this time based on its powers under the Public Utility Holding Company Act of 1935, this Court in a second decision, 332 U. S. 194, sustained the result on the ground that it was within the Commission's powers. This second decision is not the one to which the Referee referred in his opinion.

It is manifest that the *Chenery* case has nothing to do with the problem here at bar. Moreover, the question of the purchase of securities of an *insolvent* corporation was not there presented. The distinction we make was made by Judge Kirkpatrick in *In Re Philadelphia & Western Railway Co., supra,* where he said (p. 740):

> "The respondents contend that the Supreme Court in its decision in Securities and Exchange Commission *v.* Chenery, supra, announced the broad rule that directors and officers of a corporation in reorganization may traffic in the securities of the corporation. However, in that case the reorganization was under the Public Utilities Act, 15 U.S.C.A. §70 et seq. Moreover the corporation was not insolvent and, as pointed out, courts of equity have never regarded the directors and officers of a solvent going corporation as trustees in the full sense of the word."

The District Court erroneously applied a so-called "going concern" theory.

As we have previously pointed out (p. 15, *supra*), the gist of Judge Goddard's opinion was that, while it has been held that officers, directors and attorneys of a corporation, while the corporation is insolvent, may not purchase claims against it at a discount and then enforce such claims in bankruptcy proceedings at their full face

value, such cases do not seem to cover a situation where the corporation, although insolvent in the bankruptcy sense, is still a *going concern.*

There is no authority in the federal bankruptcy cases for this "going concern" theory. The cases relied upon by Judge Goddard in support of it (R. 94) were all New York decisions which, as we have pointed out (p. 41, *supra*) involved solvent corporations. Moreover, as we have said (p. 41, *supra*), this is a matter of federal bankruptcy law and not state decision.

However, assuming for the moment the correctness of Judge Goddard's qualification, the debtor was at no time during the period here involved a going concern in any true sense. It was insolvent, both under the bankruptcy and equity definitions, and would have collapsed had not the Becker-Fribourg group kept it alive.

The respondents first advanced $15,000 (the Baset mortgage) under terms and conditions which resulted in their obtaining control of the debtor, and thereafter from time to time paid the debtor's real estate taxes, which the debtor itself was unable to pay, in amounts aggregating $7,921.63. At no time did they make any demand for payment of interest on the Baset mortgage.

After October 1943, when Baset took an assignment of rents and operated the property as mortgagee in possession (which was prior to the purchase by the respondents of the greater part of their debentures), *the debtor was no longer conducting any business at all.*

Put briefly, what the respondents did was to get complete control of the debtor by advances aggregating slightly under $23,000, all of which were ultimately repaid in full with interest on the Baset mortgage, while they were acquiring in the aggregate $147,300 of the debtor's

debt securities for a total purchase of $10,195.43, on which they stand now to make a profit of over $54,000.

The life of the debtor could have been terminated at any time by the Becker-Fribourg group and it was a "going concern" only to the extent they chose to permit it to continue to exist and advanced moneys to that end. It manifestly was their purpose to keep the debtor alive until they could acquire at nominal prices its debt securities, against the time when a purchase price for the realty satisfactory to them should be received.

Summary

It is therefore submitted that as a matter of principle and consistent ruling in the federal courts, the directors of an insolvent corporation may not purchase its debt securities and enforce them in bankruptcy at their full face amount, and it is immaterial that there was no overreaching of the sellers nor hurt to the debtor. This is a sanction which implements the law's precept that a trustee must give undivided loyalty to his trust.

II

As the directors themselves were disqualified to purchase the debt securities of their insolvent corporation, such persons as these respondents, related to them, affiliated with them or acting in conjunction with them, likewise cannot profit from any dealings in such securities.

We have heretofore contended that the directors of a corporation may not purchase its debt securities while the corporation is insolvent and enforce them in bankruptcy

at their full face value, but are limited to the actual cost of such securities and interest.

This disqualification extends to these respondents one of whom is the mother of the two Becker brothers, another the wife of one of them, and the third a business affiliate who acted throughout in conjunction with all four members of the Becker family.

The case of the Becker ladies is quite clear, and the Referee, the District Judge, and the three judges of the Court of Appeals agreed that if the directors themselves were disqualified, the Becker ladies would likewise be disqualified.

The Referee found as a matter of fact that the Becker brothers had acted as agents for the Becker ladies in the purchase of their debentures and that the proof did not warrant a finding that the ladies had exercised any discretion of their own in such purchases (F. 53, R. 77). He then found as a conclusion of law that the proofs of debt of the Becker ladies should be treated as if they were proofs of debt filed by directors of the debtor (Third Conclusion, R. 78).

The District Court did not disagree (R. 93). The majority of the Court of Appeals said (R. 185):

> "As respects the Becker ladies, since they exercised no independent judgment in the investment of their funds, they are chargeable with the knowledge of their agent, Sanford Becker."

Judge Learned Hand said of the Becker ladies (R. 188):

> "They relied altogether upon the directors' advice and exercised no judgment of their own in deciding to buy. In so doing I think that they became charged with th same equities that would have

> charged the directors, had they bought on their own behalf. In short, the directors could not pass on to their principals profits which they could not have retained for themselves."

The case as to Fribourg is almost as clear.

As we have pointed out (p. 5, *supra*), Fribourg was a business affiliate of Sanford Becker and maintained his office in the suite occupied by Sanford and Norman Becker and shared a room there with Norman Becker.

Both Sanford Becker and Fribourg had purchased debentures of the debtor by the end of 1941 (R. 9, 62). When Sanford Becker brought suit to restrain a sale of the debtor's property to Chesterbrook Estates in early 1942 (F. 16-17, R. 71), Fribourg participated to the extent of furnishing an affidavit (R. 22).

When the stockholders failed to approve the sale to Chesterbrook Estates on February 17, 1942, Sanford Becker presented a proposal to lend the debtor a sum necessary to clear up the defaults on the Poughkeepsie Savings Bank mortgage ($15,000). This offer was made on behalf of "a client of mine" (Obj. Ex. 7, R. 60-61). "Client" referred to these respondents (R. 12). Baset Realty Corporation was organized for the transaction and was owned and controlled by the three respondents, the advance being made by the three in equal shares (R. 12-13; F. 20, R. 72).

It was through the Baset loan that the Becker-Fribourg group obtained ultimate control of the debtor, as we have previously explained (*supra*, pp. 5-8). Later, advances for taxes were similarly made by the three respondents jointly through Baset (R. 33-35; F. 21, R. 72).

As we have also pointed out (*supra*, pp. 8-9) the acquisition of the debentures by the three respondents was

effected as a concerted effort, Regine Becker's debentures all being purchased through Fribourg's account with E. Henry Sondheimer & Co., part of Emily K. Becker's debentures being acquired in like fashion and a considerable part of Fribourg's debentures being acquired as a result of the Winter letter, a matter which was handled by Norman Becker.

While the Referee held that Fribourg's proof of debt should not be treated as if it were a proof of debt filed by a director (First Conclusion, R. 78), the District Court felt otherwise (R. 93).

The majority of the Court of Appeals felt that nothing in the record justified a finding that Fribourg did more than invest his own funds on a "tip" received from an officer or director of the debtor (R. 185). Judge Learned Hand expressed no opinion on the subject (R. 188).

This conclusion below seems inconsistent with that reached by the same court in a subsequent decision, *Berner* v. *Equitable Office Bldg. Corporation*, 175 F. 2d 218 (1949). That was an appeal from an order in bankruptcy which denied any allowance to one Berner, who was attorney for the shareholders of the debtor in a Chapter X reorganization. The question arose under Section 249 of the Bankruptcy Act, 11 U.S.C. 649, which so far as there pertinent provides as follows:

> "No compensation or reimbursement shall be allowed to any committee or attorney, or other person acting in the proceedings in a representative or fiduciary capacity, who at any time after assuming to act in such capacity has purchased or sold such claims or stock, or by whom or for whose account such claims or stock have, without the prior consent or subsequent approval of the judge, been otherwise acquired or transferred."

The Court of Appeals held that there was no proof of conduct "which necessarily forfeited his rights under §249, or under general equity principles", but concluded that there was proof of conduct which required his allowance to be reduced in an amount which the District Court should fix in its discretion. It appeared that one Bell had purchased stock of the debtor during the proceedings on the basis of information received from Berner. The court's opinion, written by Judge Learned Hand, discusses the duties of fiduciaries and then continues (pp. 221-222):

> "Even were this not a general principle of the law of trusts, since Congress has seen fit in corporate reorganizations to impose so drastic a penalty as the forfeiture of all compensation upon any purchase whatever by an attorney—or other fiduciary—on his own account, we should fail to give proper scope to that purpose, if we were to say that he might freely favor a relative, or indeed even a friend, with information of a probable rise in price of the debtor's shares which was unknown to the shareholders. We hold that this is what Berner did, and that in so doing he committed a breach of trust to the shareholders of whom Bell bought."*

What Berner did there was really to give no more than a "tip" to his friend Bell (cf. p. 221), whereas in the instant case there was active cooperation between the directors and Fribourg.

The fact that that decision was rendered with respect to Section 249 does not distinguish it because, as hereafter pointed out, the matter is one of the equitable powers of

* Judge Swan, who wrote the majority opinion below in the instant case, concurred in this opinion.

the bankruptcy courts, irrespective of particular provisions in the act such as that particular section.

A situation similar to that at bar was presented in *In re Los Angeles Lumber Products Co., Ltd., supra,* where, it will be remembered, a brokerage concern, District Bond Company, cooperated with the director Faries in purchasing bonds of the debtor. It appeared, as here, that the District Bond Company knew that Faries was a director and was familiar with the debtor's affairs. The court decided that under the circumstances the District Bond Company was not to be treated in any way differently than Faries, citing this Court's decision in *Jackson* v. *Smith*, 254 U. S. 586.

In *Jackson* v. *Smith* a receiver for a building association arranged with his attorney and an outsider, one Wilson, that Wilson should puchase property of the association at a foreclosure sale for the joint account of all three. The foreclosure was held, was fairly conducted, there was competitive bidding, and the property was finally knocked down to Wilson as the highest bidder. Subsequently it was resold at a profit.

This Court held that under the circumstances the receiver and his associates, including Wilson, were accountable to the trust estate for all the profits realized, saying (p. 589):

> "Wilson and Smith (the receiver's attorney) are therefore jointly and severally liable for all profits resulting from the purchase; *the former although he had no other relation to the estate; the latter, without regard to the fact that he was also counsel for the receiver.*"

The principle enunciated by this Court in *Jackson* v. *Smith* is quite pertinent to Fribourg's situation here, and

it may be added that that decision is of additional interest because it appears that there the receiver obtained the best price offered at a fairly conducted open competitive sale.

A somewhat similar situation was presented in *In re Jersey Materials Co., supra,* the force of the authority being weakened, however, by the circumstance that the court stated (50 F. Supp. at p. 31) that he was persuaded that the third party had purchased the debt there involved with the intent that the director should benefit thereby, a circumstance which is not present in this case.

However, the basic consideration is that third parties who become affiliated must bear the burden of that affiliation. So, for example, in *In Re Midland United Co.*, 159 F. 2d 340 (3 Cir. 1947), a reorganization proceeding under Section 77B of the Bankruptcy Act, the wife of a fiduciary was held disqualified to purchase the debtor's securities even though she had financed her dealings entirely with her own funds (cf. p. 347), as was also the case with the respondents at bar.

This decision is of additional interest. The fiduciary himself was disqualified, having purchased securities of a subsidiary of the debtor which was at the same time a creditor of the debtor, and the court held that such disqualification was independent of any statutory sanction, saying (p. 346):

> "However, independent of Section 249 (of the Bankruptcy Act), we hold that appellant is barred from recovery under the principles enunciated in the Woods and the Avon Park cases. They hold, as already pointed out, that the bankruptcy court had plenary power to deny compensation to a fiduciary in a reorganization proceeding 'where an actual

conflict of interest exists' regardless of whether 'fraud or unfairness' resulted.

The appellant does not dispute the fact that he was a fiduciary for Utilities' debenture holders and that as such he owed them a duty of loyalty. It is necessary, then, only to ascertain from the record as to whether or not there was an actual conflict of interest."

The *Woods* case is *Woods* v. *City National Bank & Trust Co. of Chicago*, 312 U. S. 262 (1941). The *Avon Park* case is *American United Mutual Life Insurance Co.* v. *City of Avon Park*, 311 U. S. 138 (1940).

While these cases are not in point factually, they do exemplify the principle that the federal bankruptcy courts are entrusted with substantial equity power directed to the prevention of injustices and to the furtherance of fair dealing. The thought is expressed in this Court's opinion in *Pepper* v. *Litton*, *supra*, where it said (308 U. S., at p. 306):

> "That equitable power also exists in passing on claims presented by an officer, director, or stockholder in the bankruptcy proceedings of his corporation. The mere fact that an officer, director, or stockholder has a claim against his bankrupt corporation or that he has reduced that claim to judgment does not mean that the bankruptcy court must accord it *pari passu* treatment with the claims of other creditors. Its disallowance or subordination may be necessitated by certain cardinal priciples of equity jurisprudence. A director is a fiduciary."

This Court further said (p. 307):

> "In the exercise of its equitable jurisdiction the bankruptcy court has the power to sift the circumstances surrounding any claim to see that injustice

or unfairness is not done in administration of the bankrupt estate."

See also *In re Kansas City Journal-Post Co.*, 144 F. 2d 791 (8 Cir. 1944), where the court said (p. 803):

> "For claim and distribution purposes, a bankruptcy proceeding is an integrated proceeding, and the 'subject matter in litigation' in its practical aspect is the right of creditors to share in the bankruptcy assets themselves, not merely legally but in equitable relation to each other—for the assertion of a claim in bankruptcy is, of course, not an attempt to recover a judgment against the debtor but to obtain a distributive share in the immediate assets of the proceeding. The inequity which will entitle a bankruptcy court to regulate the distribution to a creditor, by subordination or other equitable means, need not therefore be specifically related to the creditor's claim, either in its origin or in its acquisition, but it may equally arise out of any unfair act on the part of the creditor, which affects the bankruptcy results to other creditors and so makes it inequitable that he should assert a parity with them in the distribution of the estate; and with the most critical force may the application be made where a fiduciary relation is involved."

The Court of Appeals below pointed out (R. 185) that in *In Re Philadelphia & Western Railway Co., supra*, the court declined to limit the claim of the father of an officer of the debtor corporation and of a claimant who was an officer of a corporation which had a management contract with the debtor for the management of the debtor's business. An examination of Judge Kirkpatrick's opinion on that point (64 F. Supp. at p. 741) does not disclose any detail of facts, but it would seem fair to assume that there

was no concerted action between the two claimants and the fiduciaries such as occurred in the present instance. It does not appear, for example, that there the fiduciary acted as agent for his father in the purchase of his father's bonds, nor that the other creditor in any way acted in concert with directors of the debtor in the purchase of her bonds. Such circumstances are present in the case at bar beyond any shadow of a doubt.

It may be that not every relative or every affiliate or business associate of a fiduciary is disabled from dealing in the securities of the fiduciary's corporation, even though insolvent. We do claim, however, that where facts are presented such as here appear, there can be no question but that the disability applies to the purchasers as well as to the fiduciaries. Any other conclusion would open wide the door to the very sort of situation which the bankruptcy courts have sought jealously to eliminate.

Obviously, to permit these fiduciaries to conduct transactions forbidden to them, by acting as agents for the mother and wife, and by cooperating with the third respondent, in the purchase of the securities acquired by them, would be to make a travesty of the basic rule and encourage the very thing which the rule forbids.

CONCLUSION

It is respectfully submitted that the orders of the Court of Appeals for the Second Circuit, the District Court of the United States for the Southern District of New York and the Referee in Bankruptcy should be reversed and that the claims of the respondents (except as to $5,000 of the Fribourg claim) should be limited to the amounts paid by them respectively for their debentures.

Dated: New York, N. Y., September 20, 1949.

Respectfully submitted,

EDWARD K. HANLON,
Counsel for Petitioner.

Supreme Court of the United States

October Term, 1949

No. 55

55

MANUFACTURERS TRUST COMPANY, as Trustee under an Indenture made by the Debtor under date of September 27, 1933, and individually,

Petitioner,

vs.

REGINE BECKER, EMILY K. BECKER and WALTER A. FRIBOURG,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF OF PETITIONER

Edward K. Hanlon,
15 Broad Street,
New York 5, New York,
Counsel for Petitioner.

APPEAL PRINTING CO., INC., 130 CEDAR STREET, NEW YORK, WO 4-3033

Supreme Court of the United States

OCTOBER TERM, 1949

No. 55

MANUFACTURERS TRUST COMPANY, as Trustee under an Indenture made by the Debtor under date of September 27, 1933, and individually,

Petitioner,

vs.

REGINE BECKER, EMILY K. BECKER and WALTER A. FRIBOURG,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF OF PETITIONER

In view of the fact that we received a page proof of the respondents' brief only late on October 17, 1949, and the brief in final form was not served on us until 12:30 P. M. on October 18 (the day before the argument), no attempt will be made to write a reply brief except in respect to three matters, for which correction will not be found in our principal brief.

I

The respondents' brief seeks throughout to obscure the finding that insolvency existed when the debentures were acquired, this line of thought culminating in the statement that the Referee's finding of insolvency was based on the

terminal result in 1946 when the property was finally sold for $300,000, "since there was no other testimony presented" (Brief, p. 40).

This is completely misleading. As a matter of fact on the trial of the case, when the petitioner sought to prove bankruptcy insolvency by recourse to the debtor's balance sheets, it was expressly conceded by the respondents' present counsel that such insolvency existed during the years in question (R. 59-60).

II

The respondents' brief also makes the contention (pp. 84-86) that there is no authority for the filing of a limitation proceeding by one creditor to reduce the claim of another creditor in an arrangement proceeding under Chapter XI.

The respondents seek to assimilate this case to the old-fashioned composition proceeding, to which it bears no resemblance. While operating under Chapter XI this was purely a liquidation proceeding.

The plan of arrangement provided for the distribution pro rata of the assets of the debtor and made provision for withholding distribution upon claims to which objection should be made.

The order confirming the arrangement was made with these very objections in contemplation, provided for the filing of objections, and went on to state:

> "ORDERED that if as a consequence of the successful prosecution of any objections filed to claims herein there becomes available for distribution to creditors, whose claims have been allowed, a further fund, such fund shall then be distributed to such

> creditors whose claims have been allowed by way of a supplemental dividend;'"*

This order was prepared and submitted by David W. Kahn, Esq., who was then and still is attorney for the debtor and who is also attorney for the respondents and who has handled this entire matter for them.

We further refer the Court to the following statement made by Mr. Kahn in his petition for allowance as attorney for the debtor:

> "Your petitioner expressed the view that any party in interest could object to any of the filed claims in a Chapter XI proceeding just as effectively as in a Chapter X, and that if any valid grounds existed for challenging claims of the so-called insiders, these could be availed of just as readily in the present proceeding as in any other."

III

The respondents' brief also states (p. 4) that there is nothing in the indenture instrument evidencing the issuance of the debentures in question which grants any authority to the petitioner to appear or file any claim in the bankruptcy proceeding, much less to file any objections to the claims of any creditors. In making this statement the brief cites Objector's Exhibit 28 (R. 174), which consisted merely of a paragraph of the indenture, which paragraph had to do with the filing of reports by the debtor. The com-

---

* The plan of arrangement, the order confirming the arrangement, and Mr. Kahn's petition for an allowance, here quoted from, are not part of the record certified to this Court, and the references would not be made but for the contention here made by the respondents.

plete indenture was not put in evidence and the ~~agreement~~ argument, therefore, is entirely improper. We should add, however as a matter of fairness that the indenture gave the trustee in the event of default power in its own name as trustee of an express trust to institute actions and proceedings to protect the rights of the debenture holders, and its claim on behalf of non-proving debenture holders was recognized and permitted to be paid without objection by the respondents' present counsel in his capacity as attorney for the debtor.

It might also be added that the petitioner is a creditor in its own right, although its claim has not yet been liquidated.

CONCLUSION

It is respectfully submitted that the orders of the Court of Appeals for the Second Circuit, the District Court of the United States for the Southern District of New York and the Referee in Bankruptcy should be reversed and that the claims of the respondents (except as to $5,000 of the Fribourg claim) should be limited to the amounts paid by them respectively for their debentures.

Dated: New York, N. Y., October 18, 1949.

Respectfully submitted,

EDWARD K. HANLON,
Counsel for Petitioner.

Supreme Court of the United States

October Term, ~~1948~~. 1949

No. 742. 55

IN THE MATTER

OF

CALTON CRESCENT, INC.,

Debtor.

MANUFACTURERS TRUST COMPANY, as Trustee under an Indenture made by the Debtor under date of September 27, 1933, and individually,

Petitioner,

AGAINST

REGINE BECKER, EMILY K. BECKER and WALTER A. FRIBOURG,

Respondents.

Respondents' Brief in Opposition to Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

DAVID W. KAHN,
Counsel for Respondents,
Office & P. O. Address,
120 Broadway,
Borough of Manhattan,
City of New York.

LODER APPEAL PRESS, INC., 65-67 Duane St., N. Y. C., Tel. WOrth-2-0689

INDEX.

CASES CITED.

PAGE

Supreme Court of the United States

October Term, 1948.

No. 742.

In the Matter
of
Calton Crescent, Inc.,

Debtor.

Manufacturers Trust Company, as Trustee under an Indenture made by the Debtor under date of September 27, 1933, and individually,

Petitioner,

against

Regine Becker, Emily K. Becker and Walter A. Fribourg,

Respondents.

Respondents' Brief in Opposition to Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

An application for a Writ of Certiorari is made by the Manufacturers Trust Company, individually and as Indenture Trustee, to correct an alleged error in a determination of the United States Court of Appeals for the Second Circuit which affirmed a decision of the United

States District Court for the Southern District of New York, overruling objections made by the said petitioner to the claims filed by the three respondents, Regine Becker, Emily K. Becker and Walter A. Fribourg in the above entitled proceeding. The order of the District Court, in turn, affirmed an order made by Hon. Peter B. Olney, Referee in Bankruptcy, after a protracted trial held before him on the said objections of the petitioner, during the course of which over 500 pages of testimony was taken and almost 100 exhibits were offered in evidence.

The printed record on appeal filed in the lower Court, which is here submitted by the petitioner in support of its application for certiorari, is by no means the complete record of this litigation.* Under the rules of the Court of Appeals for the Second Circuit, each party prints only such portion of the record as it desires, but the entire record in typewritten form is filed with the Clerk of the Court of Appeals where it may be referred to by the Court. Thus, it will not be possible in this brief to refer the Court to such portions of the record as are contained in the stenographic transcript but not in the printed appendixes. However, all statements made in this brief are fully supported by the testimony and exhibits found in the complete typewritten transcript filed in the Court below.

Comment on Petitioner's Summary Statement.

The summary statement of the matters involved, appearing at pages 3 to 6 of petitioner's brief, is so incomplete that it by no means conveys an accurate or fair

---

*References to petitioner's portion of this printed record will be designated in this brief as "A". References to respondents' portion of the printed record will be referred to as "R. A." References to testimony contained in the typewritten record in the Court below (but not printed in the appendices) will be referred to as "S. M." Petitioner's Exhibits are referred to as "Obj. Ex." and respondents' exhibits are referred to as "Resp. Exs."

picture of the events and transactions which form the subject matter of this litigation, nor, indeed, of the precise question of law presented. A much more complete and accurate review of the evidence and of the questions of law presented will be found in Referee Olney's findings and opinion printed at pages 86 to 101 of petitioner's appendix in the Court below, and in the opinion of Judge Swan in the Court of Appeals, printed at pages 9 to 22 of the petitioner's appendix to its reply brief in the Court below.

Anyone reading petitioner's brief to this Court in support of its application for a Writ of Certiorari would get the impression that what is here involved is the acquisition by directors of an insolvent corporation—pursuant to a campaign deliberately organized for that purpose—of a large batch of debt securities from public investors at a small fraction of their value under circumstances which establish failure of fiduciary duty, overreaching, and failure to disclose material facts. Nothing could be further from the truth.

It is significant that, upon the argument in the Court below and also in its brief to this Court, petitioner abandoned all charges of overreaching and failure to disclose, which constituted the basis of its objections to the claims of the respondents. Now, seemingly for the first time, petitioner relies for its objections to the claims of the respondents upon the sole ground that they were relatives or friends of the directors and that since directors themselves could not have purchased these securities and proved them for the full face amount (because the purchases were made while the debtor was insolvent) the respondents are under a similar disability because of the relationship described.

Having thus stated the ground of objection upon which it now relies, petitioner goes on to urge that certiorari should be granted by this Court because the decision of

the Court below "runs counter to long established and uniformly applied principles with respect to the fiduciary duties and obligations of directors of an insolvent corporation"; and that it has heretofore been uniformly held that directors may not traffic in the debt securities of their insolvent corporation and thereafter in bankruptcy enforce their claims upon such securities beyond the amount which they actually paid for them. We shall later show in this answering brief (1) that petitioner is entirely mistaken in its belief that the decision of the Court below runs counter to long established and uniformly applied principles and that such decision has never been approved in any Federal Court; (2) that, on the contrary, such doctrine has been approved by numerous Federal Courts as well as by the Courts of New York State, and (3) and that there is no decision in any Federal Court which supports the extreme and highly impractical and unrealistic view here pressed by petitioner.

As the Court will note from petitioner's brief, the Securities and Exchange Commission filed a brief *amicus curiae* in the lower Court. After the within brief of the respondents had been completed, the Commission served a memorandum in support of petitioner's application, repeating all of the contentions urged in the lower Court. There is one point in this memorandum of the Commission, that we think should be commented upon. The Commission claims that the questions which have arisen in the instant case are of particular importance in Chapter X proceedings, in which it has a statutory interest. The proceeding in the lower Court, however, was one brought under Chapter XI, in which the Commission has no interest or standing. Chapter XI contains no provisions for limitation proceedings, such as are found in §212 of Chapter X. Moreover, there is no authority for the proposition that limitation proceedings will lie in a Chapter XI case. Since Chapter XI is nothing but a substitution for

the old type of composition under former §12 of the Bankruptcy Act, it is extremely questionable whether, in such a proceeding, one alleged creditor may oppose the claims of others (*Nassau Works* v. *Brightwood Co.*, 265 U. S. 269 [1924], at page 271; *Equitable Holding Corporation* v. *Woody*, 63 Fed. [2d] 751 [1933], *In re Vulcan & Reiter Co.* 80 Fed. Supp. 286 [1948]).

In any event, however, the sole basis of the Commission's contention is that purchases of securities of a corporation by directors or by members of their families or friends should not be permitted after insolvency because then "potential conflict cannot be avoided since the acquisition of such securities may lead directors to postpone institution of proceedings under the Bankruptcy Act." The Commission acknowledges that a similar conflict of interest could exist in some situations even where the corporation is solvent. But the Commission, no more than petitioner, even attempts to meet the issue in the instant case as to how it could be determined when insolvency first occurred. As we later show, on pages 10 and 11 of this brief, on the basis of petitioner's own arguments on the insolvency issue, the debtor corporation was insolvent from the very moment it came into existence. None the less—and paradoxical as this may seem—the debtor corporation continued to function for a period of thirteen years in this supposed insolvent condition and paid all of its current liabilities and mortgage indebtedness in full.

Manifestly, the questions of law here involved are not abstract questions. Whether the Courts below correctly decided these legal questions depends upon the facts on which the legal determination was made. Therefore, before we proceed with a discussion of the petitioner's arguments, it will be useful to set out some of the more important facts embraced in the findings of Referee Olney, which findings, as already pointed out, have been affirmed by the District Court and the Court of Appeals.

Summary of the Findings Upon Which the Decisions of the Lower Courts Were Based.

1. None of the respondents ever was an officer or director of the debtor. Two of the respondents, Regine Becker and Emily K. Becker, were the mother and wife respectively of Sanford Becker, who was an officer and director. The respondent Fribourg had no relationship or connection with Becker, other than that he had desk space in his office (A. 27-28).

2. None of the three respondents ever had the slightest connection with the management or operation of the affairs of the debtor corporation (pp. 20-21—appendix to appellant's reply brief).

3. The moneys used to acquire the debt securities were the moneys of the respondents and none of the officers or directors of the debtor corporation had any financial interest in the purchases or participated therein in any way (pp. 20-21—appendix to appellant's reply brief).

4. All of the bonds acquired by the three respondents were purchased months and years before the parcel of real estate constituting debtor's sole asset was finally sold by the debtor—some of them as much as three years before such sale. Until such sale, no one could tell what the bonds would be worth on liquidation. None of these bonds was purchased after the filing of the petition for arrangement in the District Court or in contemplation of the filing of such petition, or at a time when the debtor corporation itself was able to buy or was in the market to purchase its own securities (A. 98).

5. The greater portion of the bonds were purchased by respondents directly from parties who were themselves officers and directors of the debtor corporation and

who had been such for a longer period than Norman and Sanford Becker, and all of whom approached the respondents with an offer to sell. One of these, Richard Kelly, the President and a Director of the debtor corporation, was a lawyer of vast experience and the counsel for one of the large savings banks in New York City (S. C. 477) who owned $8,250 of bonds; another Hays, owning $8,500 of bonds, was a member of the New York Stock Exchange; a third, Clay, was the financial adviser of the Young Women's Christian Association, which owned $7,550 of the bonds. Still another block amounting to $37,500 was acquired from the King Estate, represented by the law firm of Reynolds, Richards and McCutcheon, one of whose partners, Mr. Minor, was on the Board of Directors. That all of these officers and directors who sold their securities had full and complete knowledge of the affairs, operations and property of the debtor corporation, was overwhelmingly established (see Resp. Exs. 7, 8, 9, 10, 11, 16, 17, 22, 23, 24, 25b, 25e and 29, pp. 57 to 91 of R. A.; see also Findings 44, 47, 50 and 51; A. pp. 95-97). Even petitioner concedes that these parties knew they were selling their bonds to the respondents.*

6. The remaining bonds (with the exception of 12 purchases totaling $15,750 face amount, made by the respondent Fribourg on the so-called Winter offer) were all acquired by purchase in the open market through various brokerage firms (Obj. Exs. 11, 12 and 13, pp. 75-76 A.). Included among the sellers were such experienced and well known security dealers as Goldwater & Co., Reily & Co., Shaskan & Co., Foster & Adams, Kissel, Kinnicutt & Co., and Sondheimer & Co. In every instance these brokerage firms sold as principals for their own account, as is the practice in the over-the-counter market (see Obj. Ex. 19).

---

*As to these bonds so acquired from other directors and officers, all of the opinions in the Court below, including the dissenting opinion of Judge Hand, were to the effect that such purchases were in every respect lawful and proper and free from any attack by petitioner.

The so-called Winter offer, made more than two years before bankruptcy, under which the aforementioned $15,750 face amount of bonds was purchased, came about at the insistence of Mr. Kelly, debtor's president. When he agreed to sell his own bonds to respondent Fribourg, it was upon the understanding and condition that the same offer should be made available to all other bondholders (see opinion of Judge Swan, p. 15, appendix to appellant's reply brief).

7. Had it not been for the respondents and the honorable and generous aid which they extended to the debtor corporation, there would have been no return whatever for creditors in this case.

As Judge Swan pointed out in his opinion (see pp. 12-14, appendix to petitioner's reply brief) the debtor corporation stood in peril of imminent foreclosure of the first mortgage held by the Poughkeepsie Savings Bank in the amount of $162,000 in 1943. This was averted only by an advance of $15,000 by respondents (for which they received a second mortgage). Although every other bondholder of the debtor corporation was afforded an opportunity to participate in this second mortgage, no one saw fit to do so. With the $15,000 advanced by respondents, the arrears under the first mortgage of the Poughkeepsie Savings Bank were paid. Even after the second mortgage given to respondents went into default in 1943 and the respondents could have foreclosed their mortgage and wiped out all of the other debenture holders, they not only did not do so, but they advanced additional sums totaling $7,941.63 to meet taxes on the property. Thus the debtor corporation was able to retain the property until 1946, when it was sold for $300,000—sufficient to pay the debenture holders 41.63%. Judge Swan, reviewing these acts of the respondents said (see p. 14 appendix to appellant's reply brief):

"There is no contention that the conduct of the appellees above recounted was 'inequitable'. It was obviously very beneficial to those debenture holders who retained and have proved their bonds in the arrangement proceeding. It forestalled foreclosure by the first mortgagee and enabled the debtor to retain its property until it could be sold for a price of $300,000. * * * No complaint is made as to the price at which the debtor sold, nor is it suggested that the debtor should have sold sooner at a lesser price or have postponed the sale in the hope of obtaining a better price."

In short, the record in this case reveals not only no wrongdoing, overreaching or inequitable conduct on the part of the respondents and the directors but, on the contrary, a highly commendable and beneficial course inuring greatly to the advantage of all the creditors, which has been commended by the Referee, the District Court and the Court of Appeals.

From the foregoing it will be evident that the petitioner's contention on this application is, and necessarily must be, that despite the admitted lack of any violation of fiduciary duty and, indeed, the highly commendable and beneficial conduct of the directors, neither these directors nor even members of their families or friends had the right to purchase, at a discount, the debt securities of the debtor corporation—no matter how long before bankruptcy such purchases were made and even though most of the purchases were made direct from other directors and officers of the debtor corporation.

Petitioner concedes on this application that the sole foundation for this extreme contention advanced by it is that, although the bonds in question were purchased months and years before bankruptcy, they were none the less purchased at a time when the debtor corporation was

insolvent in a bankruptcy sense. Petitioner's argument is that directors and members of their families can purchase debt securities of their corporation while the corporation is solvent, but that such purchases are forbidden the moment the corporation becomes technically insolvent—even though the corporation continues on in business for many years after such insolvency occurs.

Applied to the facts in the instant case, petitioner's theory leads to strange results.

(a) Petitioner's claim of bankruptcy insolvency is based upon the fact that when debtor's sole asset—Calton Court Apartment building in New Rochelle—was sold in 1946, the price realized was less than the face amount of the debtor's liabilities then outstanding, represented by the issue of income bonds maturing in 1953. Petitioner then assumes, as a matter of course, that the debtor's sole asset was never worth more than the amount realized on the sale and hence that the debtor corporation was at all times insolvent throughout the whole period of its existence, to wit: 1933-1946. The fact that the City of New Rochelle assessed the debtor's property for $421,630 (A. p. 92), which was in excess of all of the debtor's liabilities, and that the cost of the property was greatly in excess of that amount, is completely disregarded. Only the final sales price received in 1946 is considered by petitioner. Manifestly, until the debtor's property was actually sold in 1946, no one could say with any certainty just what it would bring and whether this price would be as much as the assessed value, or less or more. The record clearly shows that prior to 1945 there was no market for this property or any other similar property in New Rochelle (R. A., p. 51). The only means, therefore, of fixing a valuation on such property during the period of time here involved would have been by expert appraisal. There could be no better expert appraisal than the assess-

ment made by the City of New Rochelle and, indeed, petitioner submitted none other.

On petitioner's strange line of reasoning, there was never a time when directors or members of their families or friends would have had the right to acquire the debt securities of the debtor corporation—since such debtor was at all times insolvent—and if any of them chose to go into the market and buy such securities, in the hope of a better day, they must be deemed to have done so in contemplation of a subsequent bankruptcy.

(b) The fact that during all of these 13 years the debtor was able to operate as a going concern; retain ownership of its property and pay in full all taxes, interest on mortgages and operating expenses—which alone must have exceeded $600,000 in amount, is totally ignored.* But as Judge Goddard pointed out in his opinion in the District Court (A. 121-122) even in those cases where purchases made by directors were held to be subject to the limitation rule, the corporations involved were not going concerns, but were corporations which either had already gone into bankruptcy or were contemplating doing so. Manifestly, no other rule would be tolerable or practical. We shall argue this point more fully at a later part of this brief.

The Grounds Upon Which the Decisions of the Courts Below Rested.

Petitioner asserts under this heading that the Referee, the District Court, and the Court of Appeals, although all reaching the conclusion that petitioner's objections

*The necessity for the filing of the petition for arrangement by the debtor corporation in this case was occasioned by its inability to pay in full the issue of income debentures totaling $254,450, issued in 1933, which did not mature until September 27, 1953 and on which no interest was payable unless earned. The debtor corporation paid in full all of its other indebtedness, including mortgages, interest on mortgages, taxes and operating expenses.

should be overruled, yet disagreed between themselves as to the theory or ground upon which that should be done. This assertion is not correct.

Both Referee Olney and Judge Goddard in the District Court held that even a director of a going corporation could acquire unmatured obligations of his corporation at a discount, although at such time the corporation may have been insolvent, provided the debtor had not set up any special fund to pay the said obligations; that no special liquidation had been ordered through the institution of receivership or kindred proceedings; that the debtor was not in the field to settle its own obligations, and that in acquiring such obligations the directors did not act unfairly to their corporation nor become involved in competition with it; and that the directors were not guilty of overreaching by unfairly using their special knowledge in dealing with those from whom they acquired the obligations. Such holding was supported with the citation of numerous cases—both Federal and New York State (see A. pp. 100; 120-122). Judge Goddard in his opinion emphasized that the rule of law applied by Referee Olney was undoubtedly the correct rule under the numerous decisions handed down by the Courts of New York State with respect to securities acquired by directors of a corporation that was "a going concern" (A. 120). There is thus no warrant for petitioner's claim that Judge Goddard's reasoning and conclusions differed from those of Referee Olney. Furthermore, it is again incorrect to say, as petitioner does, that Referee Olney relied principally upon the decision of this Court in *Securities and Exchange Commission* v. *Chenery*, 318 U. S. 80. That case was mentioned by the Referee merely for purposes of comparison but was not utilized as an authority.

In the majority opinion in the Court of Appeals, Judge Swan, just as Judge Goddard had done, declared that the

Federal Bankruptcy Law and not State law governs distribution of a bankrupt's assets to its creditors, citing *Prudence Realization Co.* v. *Geist*, 316 U. S. 89. Judge Swan, however, then went on to point out that even on the basis of the Federal decisions on this subject, as declared by this Court and other Federal Courts, the conduct of the respondents here complained of was not such that the Bankruptcy Court would have been justified in penalizing them by reducing their claims to the amounts paid therefor.

Thus, it will be seen that there has been no divergence of view between Referee Olney, Judge Goddard and Judge Swan. An examination of the opinions written by each clearly shows that though they considered the matter from various angles, each found the conclusion unavoidable that the respondents were entitled to prove their claims for the face amounts thereof, just as other creditors.

It is, of course, true that in his dissenting opinion in the Court below, Judge Learned Hand disagreed with his colleagues on the one question as to whether, under any circumstances, directors of a corporation who acquire securities of their corporation by purchase from others may, at a later date when the corporation becomes insolvent, prove their claims for the full amounts thereof. Judge Hand, while agreeing with Referee Olney, Judge Goddard, and Judges Swan and Chase "that the trustee's (petitioner's) case broke down so far as it rested upon the suppression of any specific information" or any other form of wrongdoing or inequitable conduct, yet advanced the view that while directors of a going corporation—even an insolvent one—should not be completely prohibited from buying the debt securities of their corporation, they should be permitted to do so only if when they made such purchases they had reasonable grounds for believing that their corporation had a good chance of effecting a

composition and going on with its business. Unless this was proved, it was Judge Hand's notion that the directors so purchasing the securities should not be permitted to make a profit on the purchase. He added, however, that he would not apply this rule to "any bonds bought by a director from a director", because "surely they stand on an equality." He also expressed doubt as to whether this rule should be applied when the purchases are not made by directors but only by members of their families.

At this point it is not necessary to make any comment upon Judge Hand's views, except to point out that, on the basis of his concession to the majority opinion of his Court, all that would remain in controversy in this case would be an utterly insignificant amount representing the profit on the few bonds that were acquired from persons who were not themselves directors and officers or Stock Exchange dealers in the securities.

Summary of Argument.

I.

The reasons assigned by petitioner for an allowance of a Writ of Certiorari are untenable. Petitioner's assertions are incorrect that the decision rendered in the Court below runs counter to long established and uniformly applied principles, and that it conflicts with decisions in the Sixth, Seventh and Tenth Circuits.

II.

There are no cases, Federal or State, holding that purchases of debt securities of a going concern by members of directors' families or friends—or even by directors themselves—constitutes a violation of fiduciary duty.

III.

The cases relied upon by petitioner as establishing a diversty of opinion in the various circuits are clearly distinguishable and none of them is in point.

ARGUMENT.

I.

The reasons assigned by petitioner for an allowance of a writ of certiorari are untenable. Petitioner's assertions are incorrect that the decision rendered in the court below runs counter to long established and uniformly applied principles and that it conflicts with decisions in the Sixth, Seventh and Tenth Circuits.

Petitioner at pages 9-14 of its brief, under the heading "Reasons Relied on for Allowance of Writ" seeks to create the impression that the decision rendered in the Court below runs counter to long established and uniformly applied principles with respect to the fiduciary duties and obligations of directors and is, therefore, erroneous; furthermore, that this decision directly conflicts with decisions of the Court of Appeals for the Sixth, Seventh and Tenth Circuits.

Both of these assertions, so made by petitioner, are completely incorrect.

The alleged claim of diversity of opinion will be dealt with under Point III of this brief. Here we deal with the other reasons urged by petitioner to support the present application for certiorari.

(a) The decisions of the Courts below in the instant case did not, as is here claimed by petitioner, break down or mitigate the standards of fiduciary duties and obligations of directors. This claim is completely untenable in the light of the conceded facts.

It has already been pointed out that this case did not deal with any acts of directors or other fiduciaries at all. The respondents now before the Court were at no time directors or officers of the debtor corporation nor in any way concerned with the management or operation of the debtor's business. The purchases were made with their own money and no director had any interest therein (see page 6 of this brief).

It is well settled, as we shall presently show, that purchases of securities made by members of the families, or friends, of directors, with their own funds and for their own benefit, do not fall in the same category as purchases made by directors. But in the instant case, the Courts below also considered the matter as though the various purchases had been made by the directors themselves, and there was unanimous opinion that even if the said purchases had been made by the directors for their own account, there would be no basis in fact or in law for penalizing them by limiting their claims,—this for the reason that there was not only a total absence of wrongdoing, misconduct, overreaching, misrepresentation or concealment, but, on the contrary, a course of action which greatly benefitted all the other creditors of the debtor corporation. Judge Swan, in the prevailing opinion in the Court below pointed out, in language of the utmost clarity, that even assuming the maximum of petitioner's contention, viz: that the Bankruptcy Court has power as a disciplinary measure to penalize directors or other fiduciaries for misconduct of any kind, no grounds for the exercise of such power existed in this case where, not alone was there no misconduct, but actual benefit in what the directors and the respondents did for the debtor corporation and its creditors.

A reading of the opinions of Referee Olney, Judge Goddard and Judge Swan will reveal that they sanctioned no relaxation of the long established and uniformly ap-

plied principles with respect to fiduciary duties and obligations of directors. Both Referee Olney and Judge Goddard pointed out in their opinions that even where directors are permitted to acquire securities of their corporation for their own account, they may only do so where they do not compete with their corporation nor resort to any overreaching by using their special knowledge (see A. pp. 100; 120-122). And Judge Swan's opinion, of course, affirms this same doctrine. What petitioner is really complaining about here is that the Courts below refused to adopt its arguments that the mere acquisition of the bonds by respondents—standing by itself—constituted a violation of fiduciary duty.

(b) There is ample authority for the proposition that even in those cases where directors are prohibited from making a personal profit themselves by purchasing the securities of their corporations, such ban does not necessarily extend to members of their families who make such purchases for their own account and with their own funds and who are guilty of no overreaching or wrongdoing. This particular subject is fully and adequately discussed in the opinion of Judge Swan at pages 19-21 of the appendix to appellant's reply brief. There Judge Swan points out that the rationale of the rule which forbids persons who knowingly confederate with a fiduciary in the breach of a trust from making any profit out of the transaction, is, as expressed in the case of *Jackson v. Smith*, 254 U. S. 586-589, that no one who knowingly joins a fiduciary in committing a wrong should be allowed to make a profit out of the transaction. Judge Swan goes on to say, however, that in the instant case even the directors were guilty of no breach of trust and, on the contrary, displayed only the most creditable and commendable conduct in the interests of all the creditors; that, therefore, there could be no possible basis for the claim

that the respondents confederated with the directors to bring about a breach of trust. Judge Swan further points out that in the instant case the respondents did nothing more than invest their moneys on the basis of advice given to them by one of the directors—advice which the respondents were free to follow or reject, and that these respondents were guilty of no improper conduct or overreaching of any character. In these circumstances, Judge Swan held that the rule of law expounded in the case of *In re Philadelphia & Western Railway*, 64 Fed. Supp. 738-741, should be applied, and there can be no doubt that the decision in that case adequately supports the result reached in the Courts below. But there are also other cases which support Judge Swan's conclusion on this point (*Anderson* v. *Blood*, 152 N. Y. 285; *Okin* v. *Securities and Exchange Commission*, 137 Fed. [2d] 398; *In Re Lorraine Castle Apartments Bldg. Corp.*, 149 Fed. (2) 55, [C. C. A. 7—1945]; certiorari denied 326 U. S. p. 728; *In re Franklin Building Co.*, 83 Fed. Supp. 263 [D. C. E. D. Wis. 1948]). Pertinent, too, is §16(b) of the Securities and Exchange Act of 1934, which expressly recognizes the right of directors to trade in securities of their own corporations but prevents them from keeping any short term profits on securities purchased and re-sold within a six months period. Even if this drastic rule were applicable in the instant situation, none of the purchases here involved would have been affected, since there never was any resale of the securities acquired and, in any event, all the purchases had been made more than six months before bankruptcy.

In the *Franklin Building Co.* case, *supra*, the precise question here involved was adjudicated, although in that case the proceeding in the District Court was one filed under Chapter X. The Trustee argued, as does the petitioner here, that certain members of the families of directors who had purchased securities with their own funds

could not prove their claims for more than the amounts paid, because they were affected by the same fiduciary duties and obligations as were the directors themselves. Judge Duffy, overruling this contention said (p. 267):

> "We must next consider whether the disabling rule hereinbefore stated should be extended to members of the family of William A. Schroeder and to Elizabeth Richter, whose husband, A. W. Richter, was an officer and director of the Franklin Building Company. I think the situation as to Mollie Schroeder, June Kuptz, and Elizabeth Richter (to the extent of $5,000) is clear. They were not in a fiduciary relationship. Their bonds were purchased with their own funds; there is no intimation in the evidence that such purchases were made as the agents of William A. Schroeder or A. W. Richter, respectively, or as a device or subterfuge to cover purchases by them. The Court of Appeals for the Seventh Circuit, in *Re Lorraine Castle Apartments Bldg. Corporation, Inc.*, 149 F. 2d 55, 57, held that Section 212 of the Bankruptcy Act does not apply to third parties, or to those who are under no fiduciary obligation. * * *"

In opposition to the cases above considered and those cited in the opinions in the Courts below, petitioner offers only the cases which we will discuss under Point III—none of which is in point and all of which, as will be shown, deal with cases where there has been affirmative wrongdoing, if not actual fraud. It is significant that petitioner failed to cite in the Courts below and fails to cite in its application to this Court, a single case adjudicating that, or any state of facts such as exists here, members of the family of a director may not, with their own money, purchase securities of the directors' corporation and retain any profit that may be earned.

II.

There are no cases, Federal or State, holding that purchases of debt securities of a going concern by members of directors' families or friends—or even by directors themselves—constitutes a violation of fiduciary duty.

As has already been pointed out, petitioner has not cited a single case—Federal or State—holding that purchases of debt securities of a going concern by members of directors' families or friends—or even by directors themselves—constitute a violation of fiduciary duty. The cases cited by petitioner, as will be shown under Point III, are all of an entirely different pattern. With few exceptions, they deal with instances of actual fraud, wrongdoing, or overreaching practiced by directors acting alone or in conspiracy with others. In none of such cases was the corporation involved a going concern.

On the other hand, the authorities supporting the right of directors and members of their families and friends to make purchases of the character here under discussion are legion. Judge Goddard pointed all this out in his opinion (A. 121-122), from which we quote the following excerpt:

> "However, these cases do not seem to cover a situation where the corporation, although insolvent in a bankruptcy sense, is still a 'going concern' for the mere fact that a corporation is insolvent does not dissolve the corporation and make the directors mere trustees of its assets if it is still a 'going concern.' *White, Potter & Paige Mfg. Co.* v. *Pettes Importing Co.*, 30 Fed. 864; *Contra Costa Water Co.* v. *City of Oakland*, 113 P. 668, 682, 159 Cal. 323; *Public Market Co. of Portland* v. *City of Portland*, 130 F. (2nd) 624, 646, 171 Or. 522; *Michigan Wolverine Student Co-op.* v. *Wm. Goodyear & Co.*, 22

> N. W. 2nd, 884, 888, 314 Mich. 580. This distinction as to the duty of a director when the corporation, although insolvent is a going concern, was recognized in *Sanford Tool Co.* v. *Howe, Brown & Co.*, 157 U. S. 312; see *Asheville Lumber Co.* v. *Hyde*, 172 Fed. 730, 733.
>
> In the case at bar these purchases were made when the corporation was a going concern and in later years even began to show an operating surplus * * *."

It is particularly significant in this case that the New York Courts, including the Court of Appeals, has on numerous occasions sustained the right even of directors to purchase debt securities of their corporation (where there is absent any element of wrongdoing or overreaching)—and this without regard to whether the corporation involved was solvent or insolvent. (*Seymour* v. *The Spring Forest Cemetery Association, et al.*, 144 N. Y. 333; *Claude Neon Lights, Inc.* v. *Federal Electric Company, Inc.*, 250 App. Div. 510; *Hauben* v. *Morris*, 255 App. Div. 35.) This same rule has been followed by Federal Courts and other State Courts (*Glenwood Mfg. Co.* v. *Syme*, 109 Wis. 355; *McIntyre* v. *Ajax Mining Co.*, 28 Utah 162; *Ripperberger* v. *Allyn, et al.*, 25 Fed. Supp. 554; *In re McCrory Stores Corporation*, 12 Fed. Supp. 267). It is, of course, true that petitioner has contended—and still contends—that none of the cases cited involved an insolvent corporation. That contention, however, is not correct. The *McCrory* case did involve an insolvent corporation, but Judge Patterson—who had also decided the *Ripperberger* case, *supra*—drew no distinction between purchases of securities of an insolvent corporation as contrasted with those of a solvent corporation and, on the contrary, he cited as authority for his view that "under ordinary conditions a director may purchase claims

against his corporation at a discount and enforce them for their full amount" the decisions in *Seymour v. The Spring Forest Cemetery Association, supra, Glenwood Manufacturing Co. v. Syme, supra.* This last mentioned case, too, involved purchases made by a president and director of an insolvent corporation, but the Court nevertheless refused to limit the claims. The decision in this last cited case contains very cogent reasoning which totally demolishes the artificial doctrine sought to be imposed here by petitioner.

It is significant that petitioner has constantly avoided and still avoids presenting any reasonable or workable formula from which it could be determined how and when, in the case of a going concern like the debtor, which managed to struggle through thirteen years of existence and pay all of its current obligations as well as its mortgage indebtedness, directors desiring to purchase the debtor's securities are to decide whether the corporation is solvent or insolvent. Are they to be required each time they wish to buy to obtain an appraisal of the debtor's property? When, as here, the debtor owns nothing but real estate which may not be sold for years to come and for which there is no ready market, how are they to make sure they do not transgress? Or are directors of such a realty corporation, whenever the immediate market value of its property seems to be less than its total indebtedness—and even though the larger part of such indebtedness does not mature for years to come—required to immediately plunge their corporation into some kind of an insolvency proceeding instead of trying to nurse it along towards a better day?

Judge Swan, discussing this aspect of the matter, pointed out that he could find no logical or practical reason for differentiating between the purchases of securities of an insolvent corporation as against a solvent one. He said (p. 18, appendix to appellant's reply brief):

"It is not immediately apparent why insolvency should make a difference. It will cost the debtor no more whether the dividend which it may be able to pay creditors goes to the original holder of the debt or to a director-assignee."

This same reasoning was adopted by the Court of Appeals of New York State in the case of *Seymour v. Spring Forest Cemetery Association, supra,* and by the Supreme Court of Wisconsin in the case of *Glenwood Mfg. Co. v. Syme; supra.* Furthermore, it is certainly significant that thus far neither the Legislature of the State of New York nor the Congress of the United States has sensed the supposed potential danger which petitioner seems to think lurks in granting directors the right to purchase securities of their corporation after it becomes technically insolvent. It is reasonable to assume that had any such supposed potential danger existed, statutory provisions to prevent it would have long since been enacted. Where Congress found that, on the basis of actual experience, some prohibition was necessary, it did not hesitate to act (see §212 of Chapter X). But admittedly none of the acts proscribed in §212 exist in the instant case.

III.

The cases relied upon by petitioner as establishing a diversity of opinion in the various circuits are clearly distinguishable and none of them is in point.

The whole thesis of petitioner's argument, contained in pages 17-26 of its brief, is that it is an established violation of fiduciary duty for directors to traffic in the securities of their corporation, no matter how free the directors may be from wrongdoing or overreaching, and that the mere purchase of such a security from a co-director or in the open market is a legal and moral wrong

for which such director must be penalized; also that where, on the directors' advice or judgment, members of their families make such purchases, they, too, must be penalized, no matter how free from wrongdoing their acts may have been. The manifest fallacy of this thesis becomes readily apparent when it is noted that petitioner itself concedes the right of directors to buy debt securities where insolvency does not exist. Why a perfectly lawful and proper act should become unlawful and tainted with moral condemnation the moment the value of a corporation's assets temporarily falls below its liabilities—although the corporation continues on with its normal business for years to come—has not been explained. Why neither Congress nor any of the State Legislatures have recognized this imaginary evil and enacted legislation to prevent it has also not been explained. And why, particularly in this case, where the directors by their heroic and extraordinary devotion to duty saved the debtor corporation's property from complete loss in foreclosure and rendered possible the excellent result finally obtained, any penalty should be imposed not against the directors but against members of their families who never occupied any fiduciary relationship to the debtor corporation, has also not been explained.

It will be sufficient to say that none of the cases cited in petitioner's petition and brief supports the impractical, unworkable, artificial and unjust rule sought to be established.

Pepper v. *Litton*, 308 U. S. 295 (1939) dealt with the question as to whether claims obtained by the controlling stockholders of a bankrupt corporation were to be treated equally with claims of other creditors where the evidence revealed "a scheme to defraud creditors reminiscent of some of the evils with which 13 Eliz. c. 5 was designed to cope."

Wendt v. *Fischer*, 243 N. Y. 439, dealt with a gross violation of fiduciary duty by an agent who brought about

a sale of a piece of property to his own corporation without disclosing to the owner that he had any interest in this corporation. This case did not deal with any purchases of securities by directors and is completely irrelevant to any issue here presented.

In *Re Los Angeles Lumber Products Co., Ltd.*, 46 Fed. Supp. 77 (1941, D. C. S. C. Cal.) involved purchases of the debtor's securities by a director after the corporation had become insolvent and a bondholders' committee had been formed to function in the reorganization proceeding which was considered imminent and which did take place shortly thereafter. That fact alone distinguishes the case from the instant case, and Referee Olney has pointed this out very clearly in his opinion (A. p. 101). Moreover—and this is important—the decision of the Federal District Court in the *Los Angeles Lumber* case was based upon two California decisions cited by the Court at page 88, thus indicating that the Court was applying a rule of local application.

In the case of *In re Jersey Materials Co.*, 50 Fed. Supp. 428, one Schweyer, the President of the bankrupt company, learning that a first mortgage upon its property in the sum of $3,500 was for sale, arranged with one of his close friends, Connor, to pick it up for the sum of $1,600. This money was supplied by Schweyer himself. Judge Forman, in holding that Connor could not recover more than the amount paid for the mortgage said:

> "I am persuaded that Connor purchased the mortgage from the Greens with the intent that Schweyer should benefit thereby and that under such circumstances Connor should recover from the bankrupt estate no more than the sum of money paid by him for the mortgage, together with interest from the date he paid it."

The complete dissimilarity existing between the facts in this *Jersey Materials Company* case and the instant

case will be at once apparent. Here the three respondents purchased the bonds in question with their own money and the directors neither had nor retain any benefit or interest in the purchase. Unlike the *Jersey* case, they were not dummies for officers or directors engaged in a plan to freeze out one of the stockholders. Moreover, the purchase in the *Jersey* case was made when bankruptcy was not only in contemplation but imminent.

In the case of *Philadelphia & Western Ry. Co.*, 64 Fed. Supp. 738 (1946) a decision of the District Court for the Eastern District of Pennsylvania, Judge Kirkpatrick, as we have already pointed out in this brief, refused to limit the claims of J. Prescott Stoughton and Agnes C. McKernan, although the first named party was the father of Russell S. Stoughton, who was an officer of the debtor corporation, and the second named party was an officer of the Conway Corporation, which had a management contract with the debtor for the management of the debtor's business. The case, far from being an authority in support of petitioner's contentions, is really an authority in support of the respondents' position. So Judge Swan held (see pp. 20-21, appendix to appellant's reply brief).

The case of *In re McCrory Stores Corporation*, 12 Fed. Supp. 267, dealt with a purchase of landlord's claims. The purchaser's claim was limited to the amounts paid, under the scrutiny clause of §77-B (11 U. S. C. A. §207[b]), because of the violation on his part of fiduciary obligations. Judge Patterson, however, reaffirmed the rule that "under ordinary conditions, a director may purchase claims against his corporation at a discount and enforce them for their full amount".

In the case of *In re Van Sweringen Company*, 119 Fed. (2d) 231, which was a reorganization under §77-B, the debtor corporation had pledged virtually all of its assets with J. P. Morgan & Co. to secure loans exceeding $39,-000,000 in amount, for which promissory notes were given to the said pledgee. These notes went into default and

the Morgan Company gave notice that it would sell the collateral at auction. By that time, of course, the debtor corporation had completely ceased doing business as a going concern. The Van Sweringen Brothers, who were officers and directors, designing to acquire control of the pledged assets for themselves and to freeze out all of the creditors of the corporation, connived with two individuals named Ball and Tomlinson to form a corporation known as the Midamerica Corp. which would buy in these pledged assets at the auction sale at a ridiculously low price. This was successfully accomplished and then the Midamerica Corp. proceeded to file a claim in the reorganization proceeding for the face amount of the notes which it had acquired at the auction sale conducted by the pledgee, Morgan & Co. The grossly flagrant character of the transaction was marked by the fact that although the Midamerica Corp. had on its own books allocated only $1.00 of the price paid on the auction sale for the note of the debtor corporation in the amount of $8,177,-023.99 and had allocated only $887 as the cost of another note in the face amount of $13,787,000, and $2.00 as the cost of a still further note of the debtor's subsidiary, Cleveland Terminals Building Company, in the amount of $1,348,614.99, it nevertheless proceeded to file claims against the debtor corporation for the full face amount of these large obligations—and this notwithstanding the fact that it had already acquired at the sale all of the collateral security which was deposited to secure these obligations. This same Midamerica Corp., it developed, had agreed by contract to give the Van Sweringen Bros. a ten year option to acquire 55% of the stock in the Midamerica Corp. at cost, plus 5% interest, and also agreed to pay them a salary of $100,000 a year. The net result of the transaction, as the Court pointed out, was that without investing a penny the Van Sweringen Bros., who as officers and directors of the debtor corporation occupied a fiduciary relationship to their creditors, came out

of the affair with complete voting control of the Mid-america Corp. for ten years; a $100,000 annual salary, and an option to buy 55% of the stock of the Midamerica Corp. for $4,250.

This was a type of fraud which a Bankruptcy Court had full power to deal with not only under the provisions of Section 77-B, but also under the inherent power to prevent fraud recognized in *Pepper* v. *Litton*, 308 U. S. 295. The Court, citing the *Pepper* case as authority, pointed out that what the Midamerica Corp. did was "within the inhibited area of bargaining not conducted at arm's length as defined in *Pepper* v. *Litton*." The Court went on to say that it was apparent "that the cupidity of persons in a fiduciary position has caused them to serve themselves in preference to those whom it was their duty to serve."

In view of the clearly dissimilar facts existing in the case at bar, it is difficult to understand on what theory the decision in the *Van Sweringen* case can be regarded as a pertinent authority. That case but reaffirms the well settled doctrine that an officer of a corporation owing the highest degree of loyalty to his creditors, will not be permitted to personally profit by persuading others to join him in violating his fiduciary obligations, and that in such a situation the guilty party who aids in the violation of the duty owing by the fiduciary cannot profit from his confederation with the fiduciary. Contrast the situation in the *Van Sweringen* case with that in the instant case, where none of the directors joined in any purchase and, indeed, had no interest in the purchases; where what was purchased were obligations of the debtor corporation and not assets of the debtor's estate. Also to be recognized is the fact that the purchases in the *Van Sweringen* case were made after the corporation had ceased doing business and its assets were being sold under the hammer, whereas in the instant case all such purchases were made over a

period of years while the debtor corporation was a going concern conducting its normal business.

In the case of *In re Norcor Manufacturing Co.*, 109 Fed. (2d) 407, C. C. A. 7 (1940), the claims against the bankrupt corporation were purchased not only by Krueger, the principal stockholder and director, but also by his attorney Lehner, as well as by Lehner's wife. All these claims so purchased were then reassigned to a corporation whose board of directors were controlled by Krueger and Lehner. The claims were purchased after the bankrupt corporation had already confessed insolvency in the Court. The Circuit Court of Appeals held that Krueger occupied a fiduciary relation, as did his attorney Lehner, and that not only did they have no right to purchase claims in competition with the corporation, but that Lehner's purpose in acquiring the claims and transferring them to the new corporation was fraudulent.

In the case of *Monroe* v. *Scofield*, 135 Fed. (2d) 725, C. C. A. 10 (1943) Monroe, a director of the bankrupt corporation, after bankruptcy had intervened, went out and bought a judgment against the corporation held by one McClain for $200, though the face amount of the judgment was $732.60. The Court held that this Monroe could not do "unless by an order of the Court", or if otherwise "he has been shorn of all power in the corporate management and his trust relationship has been fully terminated."

In Conclusion.

It will be apparent from the foregoing review of the authorities relied upon by petitioner, that all of them fall within the well recognized exceptions referred to in the opinions in the Courts below. There is, thus, no basis for the claim made by petitioner that the decision here sought to be reviewed presents any new or novel doctrines dealing with obligations and duties of directors and fiduciaries—much less that such decisions of the lower Courts

create a diversity of view between the Second Circuit and the other Circuits which require this Court to settle the correct rule.

The opinions written by Referee Olney, Judge Goddard and Judge Swan correctly interpret the rule of law applying in the instant situation, according to well settled authority. Their decision was just and correct and it should not be disturbed.

Not one single creditor of the debtor corporation joined in the objections presented by the petitioner nor asked petitioner to file such objections. The petitioner, under the provisions of the indenture (App. Ex. 28) has no authority to appear or file any claim in the bankruptcy proceeding for the holders of the debtor's debenture bonds —much less to file any objections to the claims of other creditors (*In re Indiana Flooring Co.*, 53 Fed. [2d] 263, and cases cited on page 265). In its individual capacity the petitioner is an alleged creditor for only $1,587.50 covering fees claimed to have been earned as indenture trustee, but this claim is under objection and has not yet even been allowed by the Referee in Bankruptcy.

Were this a case where respondents, or even the directors involved, had committed an injury against any of the other debenture holders, there might be some explanation for the petitioner's objections, but, as was pointed out in all three opinions below, the reverse of that is the case. Here the directors not only greatly benefited the other debenture holders, but saved the debtor's property from total loss through foreclosure of the first mortgage. Not a single one of the debenture holders who sold his securities has complained. No wonder Judge Swan expressed his wonderment as to how or why anyone could, in such a case as this, ask for the imposition of penalties.

This litigation has now been pending for almost three years and all of the Courts which have heard the case have found a total lack of merit in petitioner's conten-

tions and arguments. Petitioner has failed to show any reason for being permitted to go on further with this litigation.

It is accordingly submitted that the petitioner's motion for the issuance of a Writ of Certiorari should be denied.

Respectfully submitted,

David W. Kahn,
Counsel for Respondents,
Office & P. O. Address,
120 Broadway,
Borough of Manhattan,
City of New York.

Supreme Court of the United States

October Term, 1949.

No. 55.

MANUFACTURERS TRUST COMPANY, as Trustee under an Indenture made by the Debtor under date of September 27, 1933, and individually,
Petitioner,

vs.

REGINE BECKER, EMILY K. BECKER and WALTER A. FRIBOURG,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

BRIEF OF RESPONDENTS.

David W. Kahn,
Counsel for Respondents.

Loder Appeal Press, Inc., 65-67 Duane St., N. Y. C., Tel. WOrth-2-0689

INDEX.

STATUTES AND AUTHORITIES CITED.

STATUTES AND AUTHORITIES CITED.

Supreme Court of the United States

OCTOBER TERM, 1949.

No. 55.

MANUFACTURERS TRUST COMPANY, as Trustee under an Indenture made by the Debtor under date of September 27, 1933, and individually,

Petitioner,

vs.

REGINE BECKER, EMILY K. BECKER and WALTER A. FRIBOURG,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF OF RESPONDENTS.

Statement of the Case.

Petitioner's "Statement of the Case" is distorted and incomplete. It by no means conveys an accurate or fair picture of the events and transactions which form the subject matter of the instant appeal. Moreover, it attempts to place these events and transactions against a setting of over-reaching and wrongdoing for which, as we will show, there is not the slightest basis in fact. It will be sufficient

to mention at this point that after months of hearings and the eliciting of over 500 pages of testimony and the introduction of almost a hundred exhibits, Referee Olney, in a comprehensive series of findings of fact, dismissed these charges of wrongdoing as totally devoid of merit. His findings (R. 69-78) contain a much more complete and accurate review of the evidence than is to be found in petitioner's brief. And Judge Goddard, by affirming Referee Olney's order (R. 91-95), also found that there was no basis whatsoever for the petitioner's charges. In the Court of Appeals for the Second Circuit, both the prevailing and dissenting opinions (R. 176-188) are in accord on the point that there was here no suppression of information, wrongdoing or inequitable conduct. Judge Swan, who wrote the prevailing opinion, found, to the contrary, that the conduct of the respondents "was obviously very beneficial * * *" (R. 180).

It would seem to be clear beyond dispute that, in view of General Order 47 of the General Orders in Bankruptcy and Rule 52(a) of the Federal Rules of Civil Procedure, these findings of fact are now conclusive and may not be reargued on this appeal. Indeed, petitioner virtually concedes as much on page "12" of its brief where, acknowledging the binding force of these findings, it states that "as the matter is factual, the contention (of wrongdoing and inequitable conduct) is not pressed in this Court". Notwithstanding this concession, however, petitioner proceeds to present in its brief a sketchy review of the evidence and to reargue its contentions made in the courts below that this evidence establishes its charges of wrongdoing and inequitable conduct. The justification assigned for rearguing the adverse findings made against it is that "a brief reference to this phase of the case is necessary for a better understanding of the entire situation, and more particularly of certain comments in the two

opinions in the Court of Appeals". If this Court is to be asked by petitioner to consider evidence in addition to the legal questions involved, then we think the Court is entitled to have a fair, accurate and complete summary of the facts. Accordingly, we now present such a summary, all of which will be found to be supported by appropriate references to the printed record, the typewritten transcript and the numerous exhibits.

Before proceeding with our recital of the facts, we think the Court's attention should be called to the printed record submitted by the petitioner on this appeal. It is by no means a complete record of this litigation. Under the rules of the Court of Appeals for the Second Circuit, each party prints only such portion of the record as it desires, though the entire record in typewritten form is filed with the Clerk of the Court. The record now before this Court contains only those portions of the typewritten transcript which were printed for the Court of Appeals. Since, in this brief, we will be obliged to make references to portions of the record contained in the stenographic transcript but not in the printed appendices, we will, whenever we refer to testimony or exhibits in such stenographic transcript, identify such matter by appropriate references to the particular pages in the stenographic minutes where such testimony or other data appears. Such references will be labeled 'S.M.'

We should also state that in referring to petitioner's exhibits we shall designate them as 'Objector's' exhibits, since that is the way they are described in the printed record. The Findings will be identified by the letter F.

The Facts.

This appeal arises in a proceeding for arrangement filed by the debtor under the provisions of Chapter XI of the Bankruptcy Act.

Concededly, nothing in Chapter XI nor in any case decided under that statute authorizes or permits the filing by creditors of an application to limit the claims of other creditors to the amounts paid in acquiring such claims.

Furthermore, though petitioner in filing its objections did so in its individual capacity as an alleged creditor for $1,587.50, as well as in its capacity of Indenture Trustee, it remains the fact that petitioner's claim mentioned is still under objection and has not yet even been allowed by the Referee; also that nothing in the indenture instrument (Objector's Exhibit 28) grants any authority to petitioner to appear or file any claim in the bankruptcy proceeding —much less to file any objections to the claims of other creditors (*In re Indiana Flooring Co.*, 53 Fed. [2d] 263, and cases cited on p. 265). It is significant that though there are several hundred of such creditors, not one of them saw fit to file objections to the claims of the respondents or to join in the objections presented by the petitioner.

At the very outset it should be noted that none of the three respondents ever were officers or directors of the debtor corporation. The respondent Walter Fribourg is a friend of Norman and Sanford Becker, both of whom were directors of the debtor corporation, and the respondents Regine Becker and Emily K. Becker are respectively the mother and wife of Sanford Becker. None of these three respondents ever had the slightest connection with the management or operation of the affairs of the debtor corporation. They made their purchases with their own funds and for their own benefit, and neither of the so-called insiders, Norman and Sanford Becker, put up any money nor participated in such purchases in any way. They have not the slightest financial interest in these transactions. The respondent Fribourg was an experienced businessman and an investor in different types of securities and he undoubtedly had sufficient knowledge

concerning the debtor's property and the probable value of its bonds to form his own independent judgment as to the desirability of investing in such bonds (R. 111-112). The Becker ladies made their purchases because they had been advised by Norman Becker that, in his opinion, the purchase of the debtor's bonds at the prices at which they were available in the open market was a good speculation since—if the history of World War I was repeated, an inflationary spiral in real estate was likely to occur again after the termination of World War II—in which case these bonds might appreciate in value. Though petitioner's brief is replete with suggestions and innuendos that these three respondents profited by so-called "inside information" in purchasing their bonds, there is not the slightest justification for such a contention, as the findings of Referee Olney clearly establish. The value of the debentures purchased by the respondents depended in the final analysis upon the value of the apartment house in New Rochelle, which constituted the sole asset of the debtor corporation. Any debenture holder, or in fact any other person interested in the matter, could make just as intelligent a guess as to what this property would ultimately be liquidated for as could the respondents or the directors.

All of the bonds acquired by the three respondents were purchased months and years before the property was finally sold—some of them as much as three years before such sale—and not even petitioner dares assert that when these bonds were being purchased any of the respondents or even the Becker brothers, the so-called insiders, knew or could know when the debtor's property would finally be sold or what price would be realized therefor. None of these bonds were purchased after the filing of the petition for arrangement in the Court below or in contemplation of the filing of such petition, or at a time when the

debtor corporation itself was able to buy or was in the market to purchase its own securities (S. M. 497-498).

The debtor's property in New Rochelle, according to all of the testimony in the record, had been badly constructed and the building had been a losing venture from the time it was built (Resp. Exhibit 23, R. 155-157). During the depression of 1929 this property had been reorganized and the holders of the first mortgage certificated bonds were required to accept the income debenture bonds issued by the debtor corporation, which took over the property in the reorganization. These debentures were subordinated behind a new first mortgage placed on the property running to the Poughkeepsie Savings Bank, which mortgage went into default almost immediately after it was placed. The debenture bonds which were issued in this reorganization are the bonds which are involved in the instant appeal and they constituted practically the whole indebtedness of the debtor corporation in the arrangement proceeding. They never earned enough income to warrant the payment of any interest and at all times after they were issued they sold in the over-the-counter market at extremely depressed prices, at no time exceeding 8% (Resp. Exhibit 1, R. 142). Neither the three respondents nor Sanford and Norman Becker had anything whatever to do with the original company which owned and constructed the building, nor did they have anything to do with the reorganization that resulted in transferring the building to the debtor corporation. Their first connection with the debtor's affairs came in 1941 (more than four years before the arrangement proceeding in the Court below) when respondent Fribourg purchased some of the debenture bonds of the debtor corporation in the open market, and Sanford Becker bought some in the same way. These debenture bonds were actively traded in on the over-the-counter market.

Very few of the bonds here involved were acquired from so-called public investors.

The greater portion of the bonds were purchased directly from parties who were themselves officers and directors of the debtor corporation and who had been such for a longer period than Norman and Sanford Becker, and all of whom approached the respondents with an offer to sell. One of these, Richard Kelly, the President and a Director of the debtor corporation, was a lawyer of vast experience and the counsel for one of the large savings banks in New York City (S. M., 477) who owned $8,250 of bonds; another, Hays, owning $8,500 of bonds, was a member of the New York Stock Exchange; a third, Clay, was the financial adviser of the Young Women's Christian Association which owned $7,550 of the bonds. Still another block amounting to $37,500 was acquired from the King Estate, represented by the law firm of Reynolds, Richards and McCutcheon, one of whose partners, Mr. Minor, was on the Board of Directors. The testimony detailing the negotiations which resulted in these sales will be found at pages 106-108; 123-124; 131-140 of the record. That all of these officers and directors who sold their securities, had full and complete knowledge of the affairs, operations and property of the debtor corporation, was overwhelmingly established (See Resp. Exs. 7, 8, 9, 10, 11, 16, 17, 22, 23, ~~24,~~ 25, 25b, 25e and 29; R. 146-164; see also Findings 44, 47, 50 and 51, R. 76-77). Even petitioner concedes at page 13 of its brief that these parties knew they were selling their bonds to the respondents.

The remaining bonds (with the exception of 12 purchases totaling $15,750 face amount made by the respondent Fribourg on the so-called Winter offer) were all acquired by purchase in the open market through various brokerage firms (Obj. Exs. 11, 12 and 13, R. 62). It will be noted that included in the sellers were such experienced

and well known firms as Goldwater & Co., Reilly & Co., Shaskan & Co., Foster & Adams, Kissel Kinticutt & Co., and Sondheimer & Co. In every instance these brokerage firms sold as principals for their own account, as is the practice in the over-the-counter market (See Obj. Ex. 19—not printed). Obviously, these purchases from the brokerage houses were made on a completely impersonal basis and without any representations or discussions.

One of the paradoxes of this case is that, concededly, there would have been no salvage whatever for any of the debenture holders of the debtor corporation had it not been for the act of the respondents which petitioner assails, viz: that through their corporation Baset Realty Corp., respondents provided the debtor corporation in 1943 with $15,000 in order to avert an impending foreclosure of the first mortgage held by the Poughkeepsie Savings Bank, in the amount of $162,000. This act petitioner charges was for the purpose of placing "effective control of the situation" in the Beckers. The actual facts, however, are quite different, as will be seen from what follows. The directors of the debtor corporation had reached the end of their rope at that time and there seemed to be nothing left to do but to permit the equity of the debenture holders to be wiped out in a foreclosure sale (See Resp. Exs. 6, 11, 15, 22, 23, 24, R. 145-157). With the $15,000 then provided to the debtor corporation by the respondents for which they received a second mortgage, the arrears on the first mortgage were paid off; the property was saved and held until 1946 when it could be sold for a fair price. Though every other bondholder of the debtor corporation was afforded an opportunity to participate in this second mortgage, no one saw fit to do so (Obj. Ex. 9, R. 164-165). Even when this second mortgage went into default in 1943, and the respondents could have foreclosed it and wiped out all other debenture holders, they not only did not do so but they advanced additional sums

totaling $7,941.63 to meet taxes on the property (S. M. 417-419; 491). Through this honorable action on their part, the respondents saved the property for all the debenture holders and thereby made possible the ultimate sale of the property in 1946 for $300,000, which was sufficient to pay the debenture holders 43.61% on the dollar.

During the entire period covered by this review, the petitioner as Indenture Trustee did absolutely nothing to protect the interests of the debenture holders or to save the property from foreclosure by either the first mortgagee or the second mortgagee. It, nevertheless, throughout all this period demanded payment of its fees as Indenture Trustee, and when the property was finally sold by the debtor corporation it demanded that the proceeds of the sale be turned over to it for administration and distribution. It is an entirely reasonable conclusion that the refusal of the directors of the debtor corporation to meet this demand, on the advice of counsel, and their decision to have the fund administered through an arrangement proceeding in the Federal District Court, was responsible for the antagonistic and hostile position which the petitioner then assumed towards the respondents.

Review of Petitioner's Discussion of the Facts at Pages 5-14 of Its Brief.

It is here that petitioner has presented the distorted and grossly unfair picture adverted to at the beginning of this brief. We will comment briefly on the various topics included in petitioner's criticism.

1. **Re insolvency of debtor:** Petitioner at page four of its brief attempts to make it appear that the debtor corporation was at all times insolvent, both in the bankruptcy and in the equity sense, between 1941 and 1946

and was in no sense a "going concern" as that term is used in the cases cited by Judge Goddard in his opinion (R. 91-95). The undisputed facts are otherwise. The debtor corporation was formed in 1933 and though it was more or less constantly behind in payments on its mortgages and bills incurred in operating its property, all of such obligations were paid in full. Of course, the debtor was a "going concern". It owned and operated a large apartment house in New Rochelle for the whole period between 1933 and 1946. It bought supplies and fuel; it hired painters to decorate the apartments, and plumbers to take care of the heating system and other plumbing installations; for a time it operated a bus to take tenants to the railroad station; it hired managing agents; it paid taxes and interest on mortgages, all of these payments aggreating perhaps $600,000 or more. All this went on for a period of 13 years and no creditor who dealt with the debtor corporation in all that time has failed to receive full payment. How, in the face of these facts, it can be seriously urged that the debtor was not a going concern within the meaning of that clause as used by Judge Goddard and in the cases cited by him, is difficult to understand.

The situation here presented is analogous to that existing in *Upright v. Brown*, 98 Fed. 2d 802 (1938) where Judge Augustus N. Hand writing the opinion of the Court of Appeals for the Second Circuit said (p. 804):

> "While the company was from time to time financially embarrassed it was not proposing to wind up, and there was a reasonable probability that it would weather the storm. *Dill & Collins Co. v. Morrison*, 159 App. Div. 583, 144 N. Y. S. 894; *Drewen v. Union Discount Co.*, 2 Cir., 32 F. 2d 691, 693."

With respect to the question of bankruptcy insolvency, these are the facts: The debtor corporation on the reorganization of the property in 1933 issued $254,450 of income debentures maturing on September 27, 1953. No interest was payable on these debentures unless earned. It is this debt for $254,450 which existed when the petition for arrangement was filed in the Court below. Manifestly, if we consider the value of the debtor's property throughout the whole period here involved, viz. 1941-1946, to have been no more than the property brought on the sale held in 1946, then there is, of course, bankruptcy insolvency. But this property was assessed by the City of New Rochelle for $421,630 (see Obj. Ex. 10, not printed). Its cost was greatly in excess of that amount. The total unpaid indebtedness of the debtor corporation was only the sum of approximately $254,450, to which should be added the mortgage held by the Poughkeepsie Savings Bank of approximately $160,000, making a total of about $414,000—still less than the assessed value. Until the debtor's property was actually sold in 1946 no one could say with any certainty just what this property would bring. There was no real market for the property prior to 1946 and no means, therefore, of determining its fair value.

2. **The alleged acquiring of control of the debtor by respondents:** There can be no doubt that none of the respondents was ever in control of or even exercised the slightest influence upon the affairs of the debtor corporation. It has already been pointed out that none of the respondents were officers or directors or ever had anything whatsoever to do with either the operation, management or the sale of the debtor's property. Furthermore, considering the character of the debtor's business and operations, the obtaining of control would be and in fact was completely meaningless. At all times after Norman and

Sanford Becker became directors in April of 1942, the operation of the debtor's apartment house in New Rochelle was handled by the Westchester Trustees, a non-profit organization representing the various title companies and banks owning property in Westchester County (R. 128-131). This servicing organization had been selected by the then directors of the debtor corporation in April, 1942 (R. 128), before Norman and Sanford Becker had become directors (R. 128). Even after the $15,000 second mortgage loan had been made by the Baset Realty Corporation, the Westchester Trustees continued on as managing agent (R. 129), and when this second mortgage went into default and a rent assignment was executed by the debtor corporation to Baset in October of 1943, the Westchester Trustees continued to operate the property just exactly the same as they had been doing before the placing of the Baset mortgage (R. 130). This managing agent collected and deposited the rents; arranged for all repairs and drew all checks in payment of debtor's bills and obligations. These checks required the signature of Mr. Richard Kelly, the President of the debtor corporation (R. 130). Neither of the Becker brothers nor Fribourg had anything whatsoever to do with the actual management of the property (R. 129). Manifestly, no sale of the property could ever be made unless 66-2/3% of the stockholders (who were the same as the debenture holders) agreed, and at no time did the respondents ever own that percentage of the outstanding bonds. Indeed, when the property was finally sold for $300,000 in 1946 a meeting of the stockholders had to be called to obtain approval of such sale. Moreover, until June 28, 1944, Norman and Sanford Becker were only minority directors, and Richard Kelly and William Henry Hays, both large debenture holders, remained actively in charge of debtor's affairs as President and Vice President. Only when they resigned on June 28, 1944 after disposing of their deben-

tures were the vacancies filled by Sanford Becker's appointees. But by that time all of the bonds owned by respondent Regine Becker had been acquired, with the exception of $2,500 face amount, and a large part of the bonds owned by the other respondents had been similarly acquired. Even after June 28, 1944 there was nothing that the Board of Directors of the debtor corporation could do in furtherance of the alleged control which petitioner charges Norman and Sanford Becker with having acquired. The Westchester Trustees continued to operate the property as before and nothing whatever happened until the $300,000 offer was approved by the stockholders.

3. **Removal of debtor's office in 1942 to Sanford Becker's office:** In April, 1942 the statutory office which the debtor was obligated to maintain was moved to the Treasurer's office at 11 West 42nd Street, New York City, because Mr. Kelly, the debtor's then President, refused any longer to house the debtor in his office and no funds could be spared to rent another outside office (S. M. 344). But this in no way vested control of the debtor corporation or of its property in the Beckers since, as has been explained, there was nothing to control. The two Becker brothers still remained minority directors up to June 28, 1944 and Mr. Kelly continued on as President and Mr. Hays as Vice President (S. M. 74).

As for the suggestion in petitioner's brief that the three respondents through the Becker brothers as directors acquired for themselves secret knowledge concerning the debtor's property which was not accessible to anyone else, it will be sufficient to point out that the respondents Regine and Emily Becker never even saw any of the records or the earning statements or the profit and loss statements of the debtor corporation (S. M. 204). They did see the debtor's building from the outside but that was

the whole extent of their acquaintance with the debtor's status and operations (S. M. 205). As for the respondent Fribourg, he never saw any of the books or records of the debtor corporation (S. M. 127), and never examined any of the figures of the operation (S. M. 128). He did talk from time to time to the Becker brothers and, as was natural, asked them how the affairs of the debtor corporation were progressing (S. M. 128). He had no contact whatever with the managing agents of the property nor with the property itself (R. 113), and he knew nothing whatever concerning inquiries made from time to time by brokers regarding a sale of the property (R. 112; Finding No. 30; R. 73).

4. **Second mortgage loan of $15,000 made by Baset Realty Corporation**: Petitioner refers to this loan as one of the steps by which "the Beckers had effective control of the situation". It is also suggested at page 6 that the identity of the Becker-Fribourg group with Baset was not disclosed. Both of these statements happen to be completely erroneous, but even if they were correct they could have no possible bearing upon the sole question involved in this appeal.

Though petitioner has constantly reiterated that Sanford Becker concealed who were the parties furnishing the money to Baset Realty Corporation, the fact is that there never was such a concealment. The very checks for the $15,000 which Baset advanced on the mortgage were checks of Sanford Becker (R. 99), and the receipt which Mr. Amend, the debtor's counsel, gave for this money acknowledged these two checks of Mr. Becker (R. 99, Obj. Ex. 8; R. 164). Mr. Kelly, the President of the debtor corporation, was told that it was the respondents who were advancing the Baset money (R. 101), and that fact appears not only in the minutes of the stockholders' meetings (S. M. 266) but also in the minutes of the directors

of April 7, 1942 (Obj. Ex. 8; R. 164). In the face of these facts there is no justification for the statement made on page 13 of petitioner's brief that Mr. Amend did not know of the identity of the Becker-Fribourg group with Baset. Referee Olney's Finding No. 54 (R. 77-78), is to the effect that in the acquisition of the debentures by the respondents there was practiced no "overreaching or concealment or failure to disclose to any other debenture holders material facts".

It is difficult to understand why this point as to who put up the money for Baset has been dilated on so greatly in this case. The notion that any of the debenture holders who sold their securities to respondents would not have done so if they knew who put up the money for Baset is so fantastic as to be incomprehensible. Certainly, all of the directors and officers knew the facts. Not the slightest attempt was made to conceal them and there would have been no point in doing so.

This Baset mortgage, in our view, contains the most significant evidence of the absolute good faith and lack of over-reaching practiced by the respondents and also by the much maligned Becker brothers. It is only necessary to read Referee Olney's Finding No. 25 (R. 73) to be satisfied that it was "the assistance rendered to the debtor by the Becker women and Fribourg through Baset" which "materially helped debtor in weathering the grave financial situation through which it struggled". Except for this loan the debtor's property would have been sold in 1941 to the Chesterbrook Estates, Ltd. for $220,000, which amount, as Mr. Kelly, the debtor's then President certified, would have netted the debenture holders no more than 5% on their bonds (Resp. Ex. 22; R. 154).

It is true that when this second mortgage went into default, Baset took a rent assignment, but actually this

effected no change whatsoever in the operation of the property (R. 130). The Westchester Trustees who were then managing the property for the debtor corporation were continued and went on operating the property just as they had before (R. 130). The statement on page 8 of petitioner's brief that by the taking of this rent assignment "the actual physical operations of the property were completely under the control of Baset as mortgagee in possession, functioning through its own managing agent", is completely without basis in fact.

5. **The acquisition of debentures by respondents:** Here again petitioner sees only wrongdoing in perfectly normal transactions. The reason why some of the debentures which appear to have been bought in the Fribourg account carried by Sondheimer & Co. were paid for and are now owned by the respondents Regine and Emily Becker, has been thoroughly explained (S. M. 145-146, 244). These particular securities had been ordered purchased by respondent Fribourg but when they were delivered he was out of town and they were paid for by Sanford Becker. When Fribourg returned he was told what had happened and Fribourg stated that he was then not interested in acquiring any more securities but had no objection to the Becker ladies taking over these securities if they wished. They thereupon did so and paid for the securities with their own funds (S. M. 244-245). Referee Olney could see nothing suspicious or improper in this entirely normal business transaction. Of course, petitioner finds in these purchases from Sondheimer & Co. "a concerted plan to purchase the debentures which now form the basis of the respondents' claims". The wholly untenable character of this inference becomes clear when it is borne in mind that Sanford Becker, when he wanted to purchase any of the debtor's securities, did so openly in his own name. It has already been mentioned that he at all times

has been a holder of a block of $5,000 face amount of these bonds ever since 1941. The notion that Sondheimer, a mere dealer in the over-the-counter market, would not have sold the bonds ordered purchased by the respondent Fribourg if he had known that the Beckers were the buyers is really quite naive. What did Sondheimer, a mere trader, care as to who purchased his bonds so long as that party paid the price he wanted. Moreover, is it not entirely evident that even the people who sold to Sondheimer & Co.—and who, too, for the most part were dealers and traders (S. M. 242)—cared nothing about who the buyers were? Surely, there is no requirement that a broker who has been ordered to buy securities for a customer must reveal the name of that customer to every person who offers the desired security for sale. Even where officers and directors of a corporation wish to buy the securities of their company, no such unreasonable and impractical requirement is imposed. As Judge Swan said in his opinion (R. 182):

> "As to securities purchased from over-the-counter traders, such as the Sondheimer Company and other brokers we should hesitate to lay down the rule that the purchaser from a broker must make disclosure of why he thinks the purchase a desirable investment under penalty of being charged with overreaching if he fails to do so."

At no place has petitioner ever cited any cases supporting its extraordinary contention that the respondents were required to reveal their names not only to all the brokerage firms from whom they bought but also to the customers who sold to such brokerage houses.

What we have said above also applies to the comment in petitioner's brief at pages 8-9 regarding the so-called Winter transactions. Here, however, the petitioner's con-

jectures are even more fantastic than in connection with the Sondheimer purchase. Mr. Kelly, the President of the debtor corporation, by the time May, 1944 had arrived, had gotten thoroughly disgusted and disheartened with the situation existing in the debtor corporation and decided that he wanted to sell his bonds if he could find anyone willing to buy them. It must be remembered that at this time the debtor's fortunes had reached their lowest ebb. Both mortgages on the debtor's property were in arrears and the debtor's property was being operated at a deficit. Moreover, there was a rent assignment outstanding with the possibility that one or the other of the mortgagees might decide to foreclose (See Resp. Exs. 6, 11, 22, 23, 24, 25F, R. 145-164). Mr. Kelly mentioned all this to Sanford Becker (S. M. 135, 301), and the latter in turn told respondent Fribourg about it. This respondent then told Sanford Becker that at a price he would take a gamble on the debtor's debentures (S. M. 136). The respondent Fribourg already owned quite a block of these debentures and as he himself expressed it, he might "just as well gamble" on some more because it did not involve "a tremendous outlay of money" (S. M. 136). He mentioned this subject to his brother-in-law Winter who promptly stated that he would like to go along with Fribourg on the purchase. Mr. Kelly, conscious of his obligations to other debenture holders, stated that he would not accept any offer for his own bonds which was not made equally available to all other bondholders (Resp. Ex. 18, R. 152), and he instructed Sanford Becker to obtain Mr. Winter's offer in writing. Indeed, he himself prepared the Winter offer and the letter to the debenture holders (S. M. 303-307). It was then that Mr. Winter, who before Referee Olney made the ludicrous explanation that he knew nothing about this whole affair, admittedly signed the original offer prepared for him by Mr. Kelly, dated May 2, 1944 (Obj. Ex. 14, R. 63), which Mr. Kelly

in turn sent out to all of the debenture holders accompanied by his letter of explanation as to why he was going to accept Winter's offer for himself (Obj. Ex. 15; R. 64). Mr. Kelly, at that time, was the holder of $8,250 face amount of the bonds and these he sold under the Winter offer. After these bonds had been purchased, Winter changed his mind about going along with Fribourg (S. M. 171). He got into a feud with Fribourg (S. M. 322). Why should the respondent Fribourg buy in Winter's name to conceal his own interest in the bonds? He had already acquired in his own name, prior to the Winter offer, many of the bonds which he now holds, and long after the Winter offer he acquired additional bonds, also in his own name. Certainly, Mr. Kelly did not care whether Winter or Fribourg was the buyer of his bonds. He had made up his mind to sell for reasons deemed by him to be adequate and it is as clear as anything can be that he would have sold to anyone willing to pay the price. Mr. Kelly was an eminent lawyer practicing in New York City for a great many years; counsel and a Trustee for the Broadway Savings Bank; counsel and a Trustee of the Methodist Episcopal Church Home (S. M. 477), and President of the debtor corporation from the time of its beginning in 1933, and it is really absurd to suppose he did not know what he was doing in concluding to sell his own bonds. His written reports and communications show otherwise (Obj. Ex. 15, R. 64; Resp. Exs. 22, 23, 24, 25b, 26e; R. 154-162). With the precarious situation existing in May, 1944, there could be but little doubt that a purchase of the debtor's debentures at that point was nothing more or less than a wild gamble, in which only a speculator—not an investor—would want to engage. It is certainly not a mere coincidence that the other directors and officers all reached the same conclusion and also decided to unload their bonds at whatever price was available.

6. **Claimed lack of disclosure to the public debenture holders:** Petitioner here claims that after control had been obtained by the Becker-Fribourg group and during the time when they were purchasing the debentures, they made no disclosure to the other holders of the debtor's securities of matters which they were under a duty to disclose. This contention was rejected by Referee Olney (See Finding No. 54). In the first place, as has already been pointed out, the respondents never acquired control of the debtor corporation and at no time could they sell the property of the debtor corporation solely on their own decision. In the next place, not only was there no ~~failure~~ to disclose all the relevant information but, on the contrary, there was at all times the fullest disclosure made to the stockholders who were also the debenture holders. A full annual report of the operations of the debtor corporation showing rentals collected and expenses incurred was not only filed each and every year with the Manufacturers Trust Company as Indenture Trustee, but copies of these annual reports were also mailed out to the stockholders every year except the last year when Mr. Kelly, who was still President, declined to personally incur the expense of printing and mailing. The record contains copies of some of these annual reports (Obj. Exs. 27, 29, R. 166-167; Resp. Exs. 3, 25A, 25B, 25E; R. 143, 159, 162). Numerous debenture holders wrote letters from time to time to the President of the debtor corporation asking for information, and in each instance the ~~most~~ full and complete information was given. Samples of such letters are to be found in Respondents' Exhibits 7, 8, 10, 22, 23, 24, 25a, 25b, 25c, 25e, 25f (R. 146-163). There was the fullest discussion concerning the debtor's financial condition at the various board meetings and stockholders meetings, as clearly appears from the minutes. Both the minute books of the stockholders meetings and directors meetings are physical exhibits and can be examined by the Court. They

constitute Respondents' Exhibit 26 and Objector's Exhibit 8—not printed.

Referee Olney endeavored to obtain some definite statement from petitioner's counsel as to just what matters he claimed had been withheld or concealed from the other so-called public debenture holders (See Finding No. 39; R. 75). The only matter then claimed to have been concealed or not disclosed related to the "so-called offers to purchase debtor's property after the Spring of 1942, in an ever increasing amount". Referee Olney has carefully reviewed all the testimony offered by the petitioner and points out explicitly in Findings 40, 41, 42 and 43 that at no time from the Spring of 1942 down to the very end was there a single real offer submitted for the purchase of the debtor's property until the $300,000 offer which was accepted by the stockholders in January, 1946.

Petitioner's contention, referred to in Finding No. 39, that there were so-called offers to purchase debtor's property after the Spring of 1942 in an ever increasing amount, is totally unfounded, and it is surprising that petitioner insists on repeating the same in the face of the record facts to the contrary. From May 1, 1942, the property of the debtor corporation was being managed and operated by the Westchester Trustees (S. M. 438-439). Mr. Jordan of the Westchester Trustees, concededly a wholly disinterested witness, told of his efforts to sell the property (R. 140-141) throughout the years that he was managing it. Although he saw many different brokers during these years and gave them all of the information asked for concerning rentals; dimensions and condition of the property, and although he requested these brokers to submit offers for the property, he never received one single offer (R. 141). So far as the debtor's officers were concerned—aside from the offer of the Chesterbrook Estates of $220,000, which was turned down by the stockholders in 1942—it is the uncontradicted proof that not a single

bona fide or legitimate offer was received for the property until the Fall of 1945 (by which time substantially all of the bonds here in question had been acquired) (S. M. 349). At that time, not an offer, but an inquiry was received from a broker (R. 122). This broker inquired of Norman S. Becker whether the debtor corporation would entertain an offer of $280,000. He was told that the corporation was holding the property for $300,000 (R. 123). Except for this inquiry made in 1945, the only other interest shown in the property by any broker or buyer was an alleged offer of $250,000 received from a broker by the name of Rubin in November of 1944. The offer was supposed to have been made on behalf of one Solomon (R. 122). Although Mr. Becker tried to find out who Solomon was, he could obtain no information whatever about him (R. 122). Nor could he find out much about Rubin, the broker, who had no office (S. M. 373). The offer was not accompanied by any deposit and it was, obviously, a "phoney" proposal designed to lay the groundwork for a claim for brokerage commissions. Actually, that happened, for Rubin brought a suit for brokerage commissions against the debtor and the suit was dismissed by the Court without trial (S. M. 372).

It has been amply demonstrated that there was not the least interest displayed in the property by prospective purchasers from 1942 down to the end of 1945, and that not one real offer had been received for the property until the $300,000 offer came along in 1946. As for the supposed increasing value of the property, it is difficult to understand where petitioner claims to have established any such fact. Surely, the lack of offers and the complete indifference which buyers displayed over the entire period did not establish an increasing value. It is undisputed that the upward price trend in real estate in apartment house property located in Westchester County did not even begin until the latter part

of 1944 (S. M. 450), and that throughout the years 1942, 1943 and 1944 conditions with respect to such property were very bad and the outlook extremely pessimistic (S. M. 469; Resp. Exs. 20, 21—not printed). The property continued to operate at a loss throughout 1942, 1943 and 1944 and earned a small profit for the first time in 1945 (S. M. 446-449). We submit that, in the face of these facts, the officers of the debtor corporation would have been assuming a grave risk to tell the debenture holders that their property was steadily increasing in value, and that there was a steady stream of offers being received therefor. Such statements would have been not only untrue but reckless.

Even the dissenting opinion of Judge Learned Hand concedes the total lack of merit of petitioner's complaint upon this point. Judge Hand said (R. 186-187): "I agree that the trustee's case broke down, so far as it rested upon the suppression of any specific information that the property was going to increase in value * * *."

And Judge Swan, in the prevailing opinion, pointed out (R. 181):

> "During the period when the appellees were purchasing their debentures the debtor was receiving frequent inquiries from brokers as to terms on which its property might be bought, but no 'firm' offer to buy was submitted after the offer rejected by the shareholders in 1942 until receipt of the $300,000 offer which the debtor accepted in January 1946."

The Grounds Upon Which the Decisions of the Courts Below Rested.

Petitioner asserts under this heading that the Referee, the District Court, and the Court of Appeals, although all reaching the conclusion that petitioner's objections

should be overruled, yet disagreed between themselves as to the theory or ground upon which that should be done. This assertion is not correct.

Both Referee Olney and Judge Goddard in the District Court held that even a director of a going corporation could acquire unmatured obligations of his corporation at a discount, although at such time the corporation may have been insolvent, provided the debtor had not set up any special fund to pay the said obligations; that no special liquidation had been ordered through the institution of receivership or kindred proceedings; that the debtor was not in the field to settle its own obligations, and that in acquiring such obligations the directors did not act unfairly to their corporation nor become involved in competition with it; and that the directors were not guilty of overreaching by unfairly using their special knowledge in dealing with those from whom they acquired the obligations. Such holding was supported with the citation of numerous cases—both Federal and New York State (R. 79, 94-95). Judge Goddard in his opinion emphasized that the rule of law applied by Referee Olney was undoubtedly the correct rule under the numerous decisions handed down by the Courts of New York State with respect to securities acquired by directors of a corporation that was "a going concern" (R. 120). There is thus no warrant for petitioner's claim that Judge Goddard's reasoning and conclusions differed from those by Referee Olney. Furthermore, it is again incorrect to say, as petitioner does, that Referee Olney relied principally upon the decision of this Court in *Securities and Exchange Commission* v. *Chenery*, 318 U. S. 80. That case was mentioned by the Referee merely for purposes of comparison but was not utilized as an authority.

In the majority opinion in the Court of Appeals, Judge Swan, just as Judge Goddard had done, declared

that the Federal Bankruptcy Law and not State law governs distribution of a bankrupt's assets to its creditors, citing *Prudence Realization Co. v. Geist*, 316 U. S. 89. Judge Swan, however, then went on to point out that even on the basis of the Federal decisions on this subject, as declared by this Court and other Federal Courts, the conduct of the respondents here complained of was not such that the Bankruptcy Court would have been justified in penalizing them by reducing their claims to the amounts paid therefor.

Thus, it will be seen that there has been no divergence of view between Referee Olney, Judge Goddard and Judge Swan. An examination of the opinions written by each clearly shows that though they considered the matter from various angles, each found the conclusion unavoidable that the respondents were entitled to prove their claims for the face amounts thereof, just as other creditors.

It is, of course, true that in his dissenting opinion in the Court below, Judge Learned Hand disagreed with his colleagues on the one question as to whether, under any circumstances, directors of a corporation who acquire securities of their corporation by purchase from others may, at a later date when the corporation becomes insolvent, prove their claims for the full amounts thereof. Judge Hand, while agreeing with Referee Olney, Judge Goddard, and Judges Swan and Chase "that the trustee's (petitioner's) case broke down so far as it rested upon the suppression of any specific information" or any other form of wrongdoing or inequitable conduct, yet advanced the view that while directors of a going corporation—even an insolvent one—should ~~not~~ be completely prohibited from buying the debt securities of their corporation, they should be permitted to do so only if when they made such purchases they had reasonable grounds for believing

that their corporation had a good chance of effecting a composition and going on with its business. Unless this was proved, it was Judge Hand's notion that the directors so purchasing the securities should not be permitted to make a profit on the purchase. He added, however, that he would not apply this rule to "any bonds bought by a director from a director", because "surely they stand on an equality." He also expressed doubt as to whether this rule should be applied when the purchases are not made by directors but only by members of their families.

At this point it is not necessary to make any comment upon Judge Hand's views, except to point out that, on the basis of his concession to the majority opinion of his Court, all that would remain in controversy in this case would be an utterly insignificant amount representing the profit on the $15,750 face amount bonds that were acquired on the so-called Winter offer, discussed on pages 18 and 19 hereof.

Summary of Argument.

I.

There is no statutory prohibition, Federal or State, against the purchase of debt securities of a going concern by members of directors' families or friends—or even by directors themselves—though the corporation at the time of such purchases may be insolvent in the sense that its total assets are worth less than the amount of its liabilities.

II.

Nor are there any controlling authorities, Federal or State, forbidding such purchases and holding that in the event such purchases are made and bankruptcy later

ensues the claims of the purchasers must be limited to the amounts paid therefor.

III.

Though there are certain well recognized exceptions to the rule expounded in II, none of such exceptions are applicable to the facts involved in the instant case.

IV.

Even if the prohibitions contended for by petitioner do exist in the case of directors, they do not exist in the case of non-fiduciaries, such as the respondents on this appeal who never were directors or officers of the debtor corporation nor ever had any connection with the management or operation of the debtor's business.

V.

No considerations of public policy or equity require such an unjust, artificial and vague doctrine as is contended for by petitioner, and the imposition of such a doctrine by court decision would create an unnecessary disturbance in the common practice of business which would defeat its own purposes.

VI.

In any event, such a limitation proceeding as is here invoked by petitioner is not countenanced in a proceeding for arrangement under Chapter XI, nor does anything in that Chapter permit the filing by creditors of an application to limit the claims of other creditors.

VII.

The lower courts correctly decided the issues here presented and the order appealed from should therefore be affirmed.

Argument.

POINT I.

The fact that the respondents, Regine Becker and Emily Becker were the mother and wife of one of the directors of the debtor corporation and that the respondent Fribourg was a friend and office associate of the said Becker did not place them in the position of directors or fiduciaries and deprive them of their right to prove their claims for the full face amount of the bonds held by them.

We deal with this subject first because if this Court should affirm the rulings in the courts below, differentiating between purchases of securities made by directors and those made by members of the families and friends of directors, with their own funds and for their own account, it will become unnecessary to consider the issue as to what, if any, prohibitions exist against directors themselves.

In its brief, petitioner has blandly assumed that as a matter of law respondents were in the same position as directors. Though Referee Olney sustained this point of view with respect to the respondents Regine and Emily Becker, and Judge Goddard held that the respondent Fribourg should also be treated as though he were a director, the majority opinion in the Court of Appeals rejects this view of the case (R. 185-186). And even Judge Learned Hand, in his dissenting opinion, expressed some doubt about this rule so far as it applied to the respondent Fribourg (R. 188). As Judge Swan pointed out in his opinion, this question of law is one upon which the conclusions of the Referee and District Judge are not controlling on appeal (R. 185).

As we have already shown at pages 4 and 5 of this brief, the record shows, without dispute, that not only

were the three respondents never officers or directors of the debtor corporation, but that the purchases of the debenture bonds which they made from time to time were, in every instance, made with their own funds.' Norman and Sanford Becker, the directors, neither participated in nor have any interest whatsoever in the respondents' purchases. None of the respondents had anything whatever to do with the management or operation of the debtor's business or with the negotiations for the sale of its property (S. M. 127, 157-158, 181-182). These respondents never even saw the books or records of the debtor corporation. Nor did they have any business relations with the two directors (S. M. 97-98). The respondent Fribourg maintained desk room in the suite of Sanford Becker and the latter acted as accountant and nominal secretary of a certain corporation known as Windsor Buildings, Inc., of which Fribourg was president (R. 170). Becker, however, had no financial interest whatever in this corporation.

Assuming for the moment that there is, as maintained by petitioner, a rule forbidding directors of a corporation from purchasing its debt securities while the corporation is insolvent, the question immediately arises why such disability should extend to persons who are not directors or fiduciaries merely because these persons happen to be related to or friendly with the directors. Judge Swan held that where third parties, such as the respondents, are guilty of no overreaching or wrongdoing there is no reason to impose administrative sanctions on them so as to deprive them of any profit which they have earned by reason of their purchases. He said on this point (R. 185-186):

> "The appellees were not directors or officers of the debtor; their own funds were invested, and no officer or director of the debtor has any

interest in the debentures they purchased. In the case of *In re Philadelphia & Western Ry. Co.*, 64 F. Supp. 738, 741 (E. D. Pa.) the court declined to limit the claim of J. Prescott Stoughton who was the father of an officer of the debtor corporation. In so ruling he stressed the fact that the father was not a fiduciary who owed a duty to the debtor, that the purchases were made by the father with his own funds and for his sole account, and that neither the son nor any other person associated with the debtor had any interest in his dealings in the bonds of the debtor. For similar reasons he declined to limit the claim of Agnes C. McKernan who was an officer of the Conway Corporation which had a management contract with the debtor for the management of the debtor's business. These two claims present a closer analogy to the purchases at bar than do any of the other cases brought to our attention. It is true that one who 'knowingly confederates' with a fiduciary in a breach of trust is not allowed to make a profit from the transaction. *Jackson* v. *Smith*, 254 U. S. 586, 589. But 'knowingly confederating' means more, in our opinion, than investing one's own funds on a 'tip' received from an officer or director of a debtor. With respect to Fribourg we see nothing in the record to justify a finding that he did more than this. As respects the Becker ladies, since they exercised no independent judgment in the investment of their funds, they are chargeable with the knowledge of their agent, Sanford Becker. But since there was no overreaching of the sellers when he made the purchases for his wife and mother, we do not think the disciplinary sanction for 'knowingly confederating' with a disloyal fiduciary should be imposed."

Judge Learned Hand, in his dissenting opinion, while agreeing that the Becker ladies should stand in the same position as directors, yet expressed doubt as to what the correct answer should be in the case of the respondent Fribourg (R. 188). However, since he took the position that even directors have the right to purchase debt securities of their corporation during insolvency if they entertain the genuine expectation that the business will continue, he naturally rejected the extreme view pressed by petitioner that the mere existence of a state of bankruptcy insolvency forbids not only directors but also their relatives or friends from reaping a profit on any purchases of debt securities made during such insolvency.

Judge Swan stated that he found support for the position which he and Judge Chase took in the decision of Judge Kirkpatrick in the case of *In re Philadelphia & Western Ry. Co.*, 64 F. Supp. 738, 741 (E. D. Pa.), and also another decision written by the same Judge in the case of *In re Real Estate Mortgage Guaranty Co.*, 55 F. Supp. 749, 752 (R. 184-185). There can be but little, if any, doubt that the viewpoint expressed by Judge Swan and by Judge Kirkpatrick on the point here under discussion is sound in principle and well fortified by authority. (*Anderson* v. *Blood*, 152 N. Y. 285; *Okin* v. *Securities and Exchange Commission*, 137 Fed. [2d] 398; *In re Lorraine Castle Apartments Bldg. Corp.*, 149 Fed. [2] 55 [C. C. A. 7-1945]; certiorari denied 326 U. S. p. 728; *In re Franklin Building Co.*, 83 Fed. Supp. 263 [D. C. E. D. Wis. 1948].) In the *Matter of Wade Park Manor Corp., Debtor* (D. C. Northern District of Ohio, Eastern Division) decision of Hon. C. D. Friebolin, Special Master, dated July 28, 1949, not reported.

In the *Franklin Building Co.* case, *supra*, the precise question here involved was adjudicated, although in that

case the proceeding in the District Court was one filed under Chapter X. The Trustee argued, as does the petitioner here, that certain members of the families of directors who had purchased securities with their own funds could not prove their claims for more than the amounts paid, because they were affected by the same fiduciary duties and obligations as were the directors themselves. Judge Duffy, overruling this contention said (p. 267):

> "We must next consider whether the disabling rule hereinbefore stated should be extended to members of the family of William A. Schroeder and to Elizabeth Richter, whose husband, A. W. Richter, was an officer and director of the Franklin Building Company. I think the situation as to Mollie Schroeder, June Kuptz, and Elizabeth Richter (to the extent of $5,000) is clear. They were not in a fiduciary relationship. Their bonds were purchased with their own funds; there is no intimation in the evidence that such purchases were made as the agents of William A. Schroeder or A. W. Richter, respectively, or as a device or subterfuge to cover purchases by them. The Court of Appeals for the Seventh Circuit, in *Re Lorraine Castle Apartments Bldg. Corporation, Inc.*, 149 F. 2d 55, 57, held that Section 212 of the Bankruptcy Act does not apply to third parties, or to those who are under no fiduciary obligation. * * *"

In the *Lorraine Castle* case, *supra*, the Court of Appeals for the Seventh Circuit, while not approving the ethics reflected in the purchase by the claimants (who were not directors) of the bonds there involved yet held that there was no fraud established and that these claimants "owed no fiduciary duty to the estate or its beneficiaries", and stood in a position of "speculators in

securities who thought the bonds were selling too cheaply and that they might make a legitimate profit upon them."

The case of *Anderson* v. *Blood*, 152 N. Y. 285 (1897) enunciates, it seems to us the correct rule which should be applied in a situation such as that here under consideration. That case held that before parties acting with a fiduciary can be penalized for any violation of duty on the part of the latter, they must be shown to have had actual knowledge that what they were doing constituted a violation of the fiduciary's obligations. In that very case the Court was asked to rule that at the least the defendants owed the duty of making an inquiry. Rejecting that argument, the Court, through Judge Gray, said (p. 295):

> "The question is not whether Mrs. Blood *could* have discovered the existence of any fraud by an inquiry; but it is whether, acting as an ordinarily prudent person would have done, she was called upon, under the circumstances, to make inquiry. Were the circumstances such as to necessitate the making of some inquiry, at the peril of being charged with the knowledge of some then unperceived fact?"

If the doctrine dealing with the violation of fiduciary duty by directors is to be extended to third persons who owe no such fiduciary duty, then certainly such extension must rest upon the commission of some wrongdoing by these third persons. Can it be said that the purchase of securities in an open market for the account of such third persons, in which the directors do not share or benefit in any way, is wrong? Who can be wronged in such a transaction? Clearly, not the people who freely sell in the open market and who are in no way defrauded by false representations made to them or by having material facts

concealed from them. Is the corporation wronged? Obviously not, since, as pointed out in the case of *Seymour* v. *Spring Forest Cemetery Assn.*, 144 N. Y. 333, it will cost the corporation which issued the securities no more whether such securities are held by strangers or friends or families of the directors or directors themselves.

In the case of *Okin* v. *Securities and Exchange Commission*, 137 Fed. (2d) 398, 1943, Judge Clark, speaking for the Court of Appeals for the Second Circuit, pointed out at page 401 that officers and directors of a corporation may purchase securities of their own corporation from investment bankers and even directly from their company, and that this constitutes no fraud on other security holders. He went on to say that *a fortiori* there is nothing to prevent a sale to a friend.

The rule enunciated by the cases just considered is one grounded in common sense and in the realities of every day life. There is nothing inherently wrong or objectionable in officers or directors of a corporation making recommendations of purchase to other people, and no sound rule of policy requires that such transaction be regarded as tainted because the corporate issuer of such securities might then be in a technical sense insolvent or might, years later, resort to bankruptcy or reorganization.

Were this a situation where the respondents aided the directors as fiduciaries to commit some breach of their duty for the enrichment or profit of the fiduciaries, as in *Jackson* v. *Smith*, 254 U. S. 586, there might be some basis for petitioner's argument. But no such situation exists in this case. The directors did not and could not profit from their advice. One of the directors, Norman Becker, never owned any securities, and testified that he did not care to buy any (S. M. 385). The other director, Sanford Becker, had already bought $5,000 of the debtor's debentures in 1941 and he evidently could not or did not care to add to this personal holding. He, however, believed in the enterprise and seemed confident that the

property—if it could be carried through the war period—would finally enhance in value. He was willing, on the basis of his confidence, to have his mother and wife risk their moneys in the debtor's debentures. Whether the debtor was solvent or insolvent, what was there wrong about that and who could possibly be harmed? If these respondents had not bought these securities, other dealers or traders in the bonds would doubtless have done so. In the end, the result would have been exactly the same.

Under Section 16(b) of the Securities and Exchange Act of 1934, directors of corporations are forbidden from making any short term profits on any securities of their own companies which they may buy and re-sell within a period of six months. If the rule contended for by the petitioner were correct, there would be no logical answer to the proposition that when such directors recommend the purchase of securities of their own corporations to members of their family or friends, these parties, too, should be required to pay over to the corporation any short term profits made by them. But there is manifestly no such doctrine in existence.

The strange result which approval of petitioner's contention would produce is that the profit realized by respondents from the risk which they assumed would be passed on to the other remaining debenture holders—not to the people who sold out. Many of these beneficiaries are themselves speculators who bought their bonds at the very time and under the same conditions as respondents.

The whole philosophy of petitioner's argument that the rule against fiduciaries should be extended to third persons who are members of families or friends of directors, necessarily rests on the assumption that a wrong is committed against the whole body of security holders of a corporation if directors are permitted to give advice to close friends or relatives to buy the securities of such corporation; that such third persons are bound to make a profit by following this advice and that this must, under

all circumstances, be forbidden in the interest of the public welfare, since it would inevitably lead to the creation of a potential conflict of interest on the part of the directors. It is, it seems to us, a sufficient answer to the fallacy underlying that philosophy to point out that as yet neither Congress nor any State legislature has sensed the danger discerned by petitioner and enacted legislation to prevent all acquisition of debt securities of an insolvent corporation by directors—much less close friends and relatives of the directors. On the contrary, the right of third persons and indeed of directors themselves to freely buy and sell such corporate securities has long been recognized. (*Seymour* v. *Spring Forest Cemetery Assn.*, 144 N. Y. 333; *Hauben* v. *Morris*, 255 App. Div. (N. Y.) 35; *Glenwood Mfg. Co.* v. *Syme*, 109 Wis. 355; *Ripperger* v. *Allyn, et al.*, 25 Fed. Supp. 554 [S. D. N. Y.].) We shall have occasion to discuss these cases and others quite fully in the following point of this brief. We mention them now only to indicate that, absent fraud, overreaching or inequitable conduct, there has never been any restriction imposed by statute or even by judicial authority on the right of close friends and relatives of directors of going corporations to freely buy and sell the debt securities or capital stock of such corporations. The notion that such purchases by third parties always results in a profit is, of course, thoroughly naive. Common experience demonstrates how often losses are taken in the securities market on purchases made as result of advice and tips of directors and so-called insiders.

It seems to us manifest that nothing could be more desirable from the standpoint of the security holders of any corporation than to have a ready market available in which they can sell their securities whenever they feel obliged to do so. The more buyers there are in such a market, the better for the sellers. Certainly, in the case of securities of a corporation selling at very depressed levels which reflect the condition of the corporate business,

t is particularly desirable that those security holders who cannot afford to take the risk of retaining their securities should be in a position to sell. If members of families and friends of directors are willing to take the risks involved in buying such securities, they should be permitted to do so and no penalty should be imposed on them which is not imposed on strangers who, under the same conditions, make similar purchases. As Judge Lindsey pointed out in his decision in the *Lorraine Castle* case, *supra*, page 58:

> "To reduce the participation to the amount paid for securities, in the absence of exceptional circumstances which are not present here, would reduce the value of such bonds to those who have them and want to sell them. This would result in unearned, undeserved profit for the debtor, destroy or impair the sales value of securities by abolishing the profit motive, which inspires purchasers."

Significant it is that both petitioner and the Securities and Exchange Commission have failed to cite a single case where, on similar facts to those here existing, the courts have entertained the limitation proceeding against third persons. As we shall show in the next point where we discuss the right of directors themselves to purchase debt securities of their corporation, all the cases cited by petitioner and the Commission where the claims of third persons have been limited to the amounts paid will be found to fall under well recognized exceptions to the rule which we are here discussing. In all of these cases it will be found that the purchases were made (1) while reorganization proceedings were pending, (2) in contemplation thereof, or (3) where there was express violation of fiduciary duty if not actual fraud.

POINT II.

(a) Even if the respondents had been directors or fiduciaries of the debtor corporation, they would have had the right to make the purchases of debtor's securities here involved.

(b) The Insolvency Restriction Doctrine, even if it exists, could not and should not be applied in this case.

As we mentioned in Point I, if the Court adopts the distinction between purchases made by directors and those made by members of the families and friends of directors, which has been approved in the lower courts, it will be unnecessary to consider the argument which we make in this Point II.

Assuming, however, that this Court does not accept the distinction above referred to and considers that the respondents stood in the same position as directors, then we propose to show that even the directors of the debtor corporation would have had the right to purchase the securities here involved without standing in peril of a limitation proceeding.

At the outset, it will be useful to bear in mind that even petitioner concedes the right of directors to freely buy and sell debt securities of their corporation while such corporation remains solvent. The contention of the petitioner is that when insolvency occurs directors lose the right to make such purchases and that if they insist on doing so, they will have their claims limited to the amounts paid.

The impossibility of applying the insolvency restriction doctrine here.

The insolvency in the instant case on which petitioner relies for the application of the limitation doctrine arises out of the fact that when the debtor's property was sold in 1946 for $300,000, that amount was insufficient to pay all

of the debts of the debtor corporation. From this, petitioner assumes that the debtor's property was never worth any more than $300,000 during the five-year span between 1941 and 1946 when the bonds here involved were acquired by respondents. Petitioner called no appraiser or other expert witness to testify to the value of debtor's property at any period. It merely relied on the final sales price obtained in 1946. We respectfully submit that this is wholly insufficient to establish insolvency on the material dates here involved, viz. the date of acquisition of the securities (*Acme Food Co.* v. *Meier*, 153 Fed. 74 [C. C. A. 6, 1907] at p. 77; *Burns Bros.* v. *Cook Coal Co.*, 46 Fed. [2d] 31 [C. C. A. 3, 1931] at p. 32). As was said in the *Acme Food* case:

> "If the act of bankruptcy be the giving of a preference under subdivision 2, or the permitting of a preference through a legal proceeding under subdivision 3 of the same section, there must be a state of insolvency at the time of the preference and solvency or insolvency at the time of the filing of the petition can only have a reflex importance, if any."

If the price realized on the sale of the property in 1946 has any cogency in the determination of the value in the preceding five years, much more cogency attaches to the fact that the City of New Rochelle assessed the debtor's property throughout all that period at $421,000—an amount which establishes complete solvency.

Petitioner obviously recognizes the infirmities in its claim of bankruptcy insolvency and so it also contends at page 19 of its brief that the debtor was likewise insolvent in the equity sense. The support relied upon for this last contention is Finding No. 12 made by Referee Olney (R. 71) and Respondents' Exhibit 17 (R. 68). To be sure, the debtor corporation was in a precarious condition during the years 1942-1944, more or less continually oper-

ating at a loss but, as we pointed out at page 10 of this brief, it did manage to hold on to its property and avoid closing down and finally paid all of its current creditors 100 cents on the dollar. Throughout the period beginning with the debtor's organization in 1933 and ending with the sale of the property in 1946, the debtor corporation incurred debts aggregating perhaps $600,000 or more. Every penny of this it paid in full. If it fell behind one month it made this up in the following month or months. No one who extended any credit to the debtor corporation lost one penny. The only people who took any loss were the bondholders of the predecessor corporation who on the reorganization in 1933 accepted the income debenture bonds issued by the debtor corporation. It is these original bondholders of the prior company and only they who took a loss. Thus the most that can be said about the debtor's supposed equity insolvency is that such debtor occasionally became unable to meet its current obligations as they matured but it met them at a later date. That such a situation as we have described would justify a finding of equity insolvency is most doubtful. Referee Olney refused to make any such finding. All he found (F. 55, R. 78), is that when the purchases here under consideration were made "debtor was insolvent in that the aggregate of its property was not at a fair valuation sufficient in amount to pay its debts," * * * This finding he, of course, based on the terminal result in 1946 when the property was finally sold for $300,000, since there was no other testimony presented.

The first question to consider is whether, assuming the correctness of the petitioner's contention that insolvency (undefined) should cut off the right therefore enjoyed by directors to freely purchase the debt securities of their corporation, such a vague, indefinite and impractical rule can possibly be applied or enforced in a case such as the present. In the *Wade Park Manor Corp.* case, decided by Special Master Friebolin, to which we have

heretofore referred, the situation with respect to insolvency was almost identical with that in the instant case. The learned Special Master made the following observations on the utter impossibility of applyin gand enforcing any such proposed rule as that here under discussion:

> "The difficulty of applying the rule contended for, is manifest in a case such as this where the purchases covered a period of years long antedating the reorganization proceeding; and where, possibly, in the meantime the debtor might have become solvent (in the bankruptcy sense) for a short period before again becoming insolvent (in the bankruptcy sense). How can one tell what, at a particular time, the real value of property, such as the lease herein, is? Would any court hold a director liable as a *strict trustee regardless of* good faith, if he purchased bonds of his corporation five or ten years ago when the corporation's liabilities —some unmatured—exceeded its assets, then later, the assets equalled or exceeded the liabilities before it again became insolvent? I think not. A director would never be safe in purchasing claims. There would, it seems to me, have to be a showing of more than mere bankruptcy insolvency of a corporation to impose upon a fiduciary, such as a director, a duty of refraining under all circumstances from purchasing claims against the corporation.
>
> It occurs to me, too, that the rule contended for would create quite a disturbance in the common practice of business."

We have already adverted to the interesting fact that in the instant case there was never a time when on the petitioner's theory the directors of the debtor corporation could have purchased its securities, though the debtor

corporation remained in business for 13 years. If the debtor was insolvent in the five-year period preceding the petition for arrangement in the District Court, it was equally insolvent in the eight years prior thereto. Thus, on the strange reasoning of the petitioner, no one but total strangers or outside speculators would have had the right to buy the debtor's debentures at any time. This, it seems to us, is such an unreasonable position that it refutes itself. It seems even more unreasonable when it is borne in mind that no one could know during the years from 1933 down to 1946 what the debtor's property would ultimately bring and whether the appraised value thereof fixed by the City of New Rochelle might in time be realized—if the property could be held long enough. The record abundantly establishes that there was no ready market for this property prior to 1946. It had been offered for sale by Mr. Jordan of the Westchester Trustees (R. 140-142) and it had been offered for sale by the corporation's directors, but no offer was forthcoming. That, of course, did not mean that the property had no intrinsic value or even that it was not worth the full amount of the assessment fixed by the City of New Rochelle. It only meant that there was no ready market for the property. Doubtless, if the appraisers employed by the City of New Rochelle had been called as witnesses, they would have testified that their assessment figure of $421,000 was fair and that in due course of time that price could be obtained for the property. It is an undisputed fact that though the property could not be sold at any price prior to 1946 the property was getting better and finally did begin to enhance in value as a result of the inflation which set in after the end of the War.

How, under the circumstances reviewed, were the directors of the debtor corporation to judge whether they could with safety purchase the securities of the debtor corporation at any time during the 13 years of its ex-

istence, and—much more—how could the respondents make such determination?

The fundamental difficulty with petitioner's contention is that it ignores the realities and the practicalities of the situation, and it erroneously assumes that the insolvency of such a corporation as the debtor corporation, owning but one parcel of real estate, is clearly signalled by some event whose import none can mistake. Moreover, this contention of the petitioner fails to meet the requirement that there must be some definitely ascertainable standard of guilt before one can be penalized for violating a statute or regulation (*Winters* v. *New York*, 333 U. S. 507, at pp. 509, 510; *Connally* v. *General Const. Co.*, 269 U. S. 385; see also 83 L. Ed., pp. 893-921). As was said in the *Connally* case, "a statute which either forbids or requires the doing of an act in terms so vague that men of common intelligence must necessarily guess at its meaning and differ as to its application, violates the first essential of due process of law." Obviously the rule here asserted by petitioner falls squarely within the condemnation of that decision.

Once a corporation applies for bankruptcy or reorganization, no officers or directors or others standing in a fiduciary relationship to the corporation may then traffic in its securities (R. 183-184). That constitutes one of the well recognized exceptions to the rule which we are here discussing. But the filing of a petition for bankruptcy or reorganization is a definite, overt act which all may know about. It is one thing to say that after such a definite, overt act fiduciaries should not be permitted to traffic in the insolvent corporation's securities, but it is an entirely different matter to argue that while there is no bankruptcy or reorganization and while the corporation is pursuing its normal business—albeit with difficulties—directors before daring to buy the corporation's securities, when they regard these as unduly depressed, must obtain an appraisal and then run the risk that even this appraisal may later turn out to have been erroneous.

Another insurmountable difficulty arising out of the vagueness and indefiniteness of the rule contended for by petitioner is that it would even throw into question securities purchased by directors of a corporation during a temporary period of insolvency, later followed by solvency. How are such purchases to be treated? Logically, of course, they would have to be condemned under the petitioner's rule because, having been made while the corporation was insolvent, there could be no defense of any kind asserted in support of such purchases,—either good faith, confidence in the future of the property or anything else. Yet, as Special Master Friebolin pointed out, it is exceedingly unlikely that any court would hold a director to account for purchases so made if the issuing corporation finally achieves solvency.

Anyone making a calm and fair analysis of the complex elements that are involved in the question here under discussion would surely have to agree that it is far more important that directors be permitted to purchase securities of a corporation that might be temporarily insolvent but which they hope they can restore to full health that they be permitted to purchase only securities of a corporation whose solvency cannot be questioned. In the latter group of cases it is not at all likely that the securities would sell at very depressed levels. After all, debt securities of solvent, prosperous companies do not ordinarily sell at substantial discounts. It is only in the case of corporations of questionable solvency and with poor earning records where their debt securities sell down to inordinately low levels. It would certainly seem reasonable that directors who have the courage and vision to believe that they can restore these corporations to financial health and are willing to back up their judgment with their own money by buying the debt securities of such corporations should be encouraged to do so—absent, of course, wrongdoing or inequitable conduct, for

which the courts always have the power to impose necessary sanctions.

We respectfully submit that the very vagueness of the rule contended for by petitioner and the difficulty of applying it are sufficient to compel rejection of any such rule.

Under the Decisions of the Courts of the State of New York, Directors of a Corporation Have Never Been Forbidden From Purchasing the Debt Securities of Such Corporations—Even During a Period of Insolvency.

The purchases here in question were all made in New York State. While the petitioner seems to suppose that this is immaterial and that only so-called Federal law or doctrines govern, we believe that there is ample authority for the contention that the New York law on this subject cannot and should not be ignored, but on the contrary should be given effect.

The leading New York case on this subject and one that is frequently cited in Federal and State decisions is *Seymour* v. *Spring Forest Cemetery Assn., et al.*, 144 N. Y. 333, referred to in the opinion of Referee Olney (R. 79), and in the opinion of Judge Goddard (R. 94). In that case, the Court of Appeals of the State of New York, speaking through Judge Finch, said in an unanimous opinion, at pages 342-343:

> "But the further claim is made that, because Hotchkiss and Seymour were officers of the corporation, holding a fiduciary relation as trustees or directors, they could not lawfully buy the valid and outstanding obligations of the company at less than par and enforce them for the full amount against the debtors. If that be sound doctrine, as is stoutly maintained, if directors cannot in any case invest in

the bonds of their own companies except at the peril of a constructive fraud, if they cannot safely buy such bonds below par, because they deem them unduly depressed, if titles to corporate obligations passing through their hands become tainted by their touch, it is quite time that the courts should give, what they have not given, a very definite and distinct warning."

Judge Finch then goes on to point out that there are certain exceptions to the rule, (1) that a director cannot buy debt securities at a discount if it was his duty to do so for his principal or, in other words, where the corporation was itself in the market to buy its own securities; and (2) where a director "makes a contract in behalf of his principal with himself directly or indirectly as the other party to the agreement".

Judge Finch then proceeds to point out that in the case before him the two directors neither "bought in any property of the company nor dealt with the corporation in any respect" and that "they made their contract, not with it, but with third persons capable of protecting their own rights, and bought nothing which the corporation owned or to which it had a right." Judge Finch emphasized that the entire basis for the exceptions referred to rests on the "collision between trust duty and personal interest" and that "the equitable prohibition has no application where there is no such possible inconsistency." He then states at page 344:

"Unless some special fund has been provided, or some special liquidation has been ordered, the director owes no duty to his company to discharge or buy in the outstanding bonds, and may purchase for himself because no inconsistent trust duty has arisen. Why should he not? While the bonds are running to their maturity, and the corporation is

not able to extinguish them, is not bound to do so, does not even wish or seek to do so, what does it matter who holds the securities or on what terms they pass from hand to hand? It seems to me that we are asked to crowd the rule almost to the verge of an absurdity, and to inflict a vital injury upon business interests by tainting with invalidity the holding by a director of the unmatured obligations of the corporation bought by him in the open market and not put in liquidation or sought to be extinguished. There must at least be some fact or circumstance which charges the trustee with a present duty to act for his company in respect to the bonds, which duty is or may be inconsistent with a personal purchase. No such duty rested upon Hotchkiss and Seymour, and they had a right to buy and hold for their own benefit."

And in the much more recent case of *Claude Neon Lights, Inc.* v. *Federal Electric Company, Inc.*, 250 App. Div. 510, the Appellate Division for the First Department, in a decision written by the late Presiding Justice Martin, not only followed the doctrine of the *Seymour* case but approved it (see pp. 517-518). He pointed out in that case that the Federal Electric Company, whose securities constituted the subject matter of the litigation, was not in the market to buy the portfolio of stocks which were later acquired by the defendant directors, and that, therefore, such directors were not competing with their own corporation when they went out and acquired these securities. Mr. Justice Martin very tersely summed up the correct rule applying in these situations when he said:

> "In the absence of proof that the director acted in opposition to or in competition with his corporation, the contract for the sale of the securities may not be upset."

In the case of *Hauben* v. *Morris*, 255 App. Div. 35, the Appellate Division for the First Department again reaffirmed the same rule. In an exhaustive opinion by Mr. Justice Untermyer, the Court said:

> "Likewise, a director may ordinarily buy at a discount the unmatured obligation of his corporation with the intention of collecting in full when the obligation matures. (*Seymour* v. *Spring Forest Cemetery Assn.*, 144 N. Y. 333; *Glenwood Mfg. Co.* v. *Syme*, 109 Wis. 355; 85 N. W. 432; *McIntyre* v. *Ajax Mining Co.*, 28 Utah, 162; 77 P. 613.)"

This ruling of the New York Courts has been consistently applied by the Federal Courts in New York.

In the case of *Ripperger* v. *Allyn, et al.*, 25 Fed. Supp. 554, former Judge Patterson, then sitting in the Southern District Court, passing on a motion to dismiss a complaint in a suit for an accounting, said:

> "Directors and those who occupy a similar relation to a corporation may buy up claims held by strangers against it or may purchase from others liens on corporate property without accountability for profits, when the transaction is fair to the corporation and involves no competition with it."

See, too, *In Re McCrory Stores Corporation*, 12 Fed. Supp. 267 (S. D. N. Y.), also decided by Judge Patterson.

Though as Judge Goddard pointed out in his opinion in the instant case (R. 94)

> "federal bankruptcy law, not state law, governs the distribution of a bankrupt's assets to its creditors * * *"

he also pointed out (R. 94) that

> "the validity of a claim, in the absence of overruling federal law, is determined with reference to state law."

In the decision of this Court in *Vanston Bondholders Protective Committee* v. *Green*, 329 U. S. 156, cited by Judge Goddard, Mr. Justice Frankfurter in his concurring opinion went on to emphasize that the laws of the 48 States governing commercial transactions cannot be, and are not to be, wiped out when a corporation is adjudicated a bankrupt. He added that Congress never intended any such result, saying:

> "To establish uniform laws of bankruptcy does not mean wiping out the differences among the forty-eight States in their laws governing commercial transactions. The Constitution did not intend that transactions that have different legal consequences because they took place in different States shall come out with the same result because they passed through a bankruptcy court. In the absence of bankruptcy such differences are the familiar results of a federal system having forty-eight diverse codes of local law. These differences inherent in our federal scheme the day before a bankruptcy are not wiped out or transmuted the day after."

Petitioner's answers to the argument which we have just made is that (1) even if the New York decisions do support the ruling of the lower courts in the instant case, such decisions would not govern because under the cases of *Prudence Realization Corp.* v. *Geist*, 316 U. S. 89; *American Surety Co.* v. *Sampsell*, 327 U. S. 269; *Heiser* v. *Woodruff*, 327 U. S. 726, and the *Vanston* case, *supra*, "federal law controls the distribution to creditors in bank-

ruptcy," and (2) that in any event the formidable array of New York State and Federal authorities which we have cited do not apply because "in none of these cases did it appear that the corporation was insolvent".

Petitioner's contentions just discussed are incorrect. The *McCrory* case, *supra*, decided by Judge Patterson did involve an insolvent corporation and Judge Patterson drew no distinction in his opinion between purchases of securities of an insolvent corporation as contrasted with those of a solvent corporation. On the contrary, he cited as an authority for his view that "under ordinary conditions a director may purchase claims against his corporation at a discount and enforce them for their full amount; the decision in *Seymour* v. *Spring Forest Cemetery Association*, *supra*, and the decision in *Glenwood Mfg. Co.* v. *Syme*, 109 Wis. 355, which was decided by the Supreme Court of Wisconsin and which dealt with purchases of securities made by a president and director of an insolvent corporation.*

The only case that petitioner has been able to discover which it believes supports its view that the New York courts distinguish between solvent and insolvent corporations, in the situation here under discussion, is *Bulkley, et al.* v. *Whitcomb*, 121 N. Y. 107 (1890). That case, however, is completely inapplicable. It dealt with an attempt on the part of a stockholder against whom judgment had been recovered by a creditor of the corporation under a statute of the State of New York, rendering stockholders liable to creditors for debts contracted before the capital stock called for by the certificate of incorporation is paid in, to offset against such judgment a claim against the corporation acquired by him without any consideration whatever. The gist of the Court's opinion is to be found in the following excerpt appearing at page 112:

---

*This decision, it should be added contains very cogent reasoning which totally demolishes the artificial doctrine sought to be here imposed by the petitioner.

> "The stockholder's liability is a trust fund, which the directors are bound to apply honestly and in good faith for the interest of the company and its creditors, and the officers cannot be allowed to avail themselves of their position and opportunity to deplete that fund for their own benefit, so as to escape the supervision of equity."

The notion that this *Bulkley* case expounds a rule of law different from *Seymour* v. *Spring Forest Cemetery Association, supra,* is completely fallacious. Both opinions were written by the same Judge. The *Seymour* case was decided long after the *Bulkley* case. It is obvious that if the rule of law, which petitioner seems to think the *Bulkley* case enunciates, dealt with purchases of debt securities by officers or directors of an insolvent corporation, the decision in the *Seymour* case would have been to the contrary of what it was. But the Bulkley decision was not even mentioned by Judge Finch in his opinion in the *Seymour* case, thus clearly demonstrating that the two cases deal with altogether different facts and involve different principles of law.

It is significant and a complete answer to petitioner's notion that all of the New York cases cited by us deal only with solvent corporations that nothing was said either in the *Seymour* case or in any of the other New York cases to so much as suggest that the rule expounded in these cases does not apply to insolvent corporations.

That there is no basis for the claimed distinction is clear from the two decisions of former Judge Patterson in the *Ripperger* and *McCrory* cases, *supra,* to which we have just referred. While the element of insolvency was not present in the first named case, it is important to note that Judge Patterson in discussing the general rule drew no distinction between purchases of securities of an insolvent corporation as contrasted with those of a solvent corporation. The second named case, however, dealt with

an insolvent corporation and, although there the purchaser of landlords' claims was limited to the amounts paid, under the scrutiny clause of §77-B (11 U. S. C. A. §207[b]), because of the violation on his part of fiduciary obligations, Judge Patterson cited as authority for his view that "under ordinary conditions, a director may purchase claims against his corporation at a discount and enforce them for their full amount", the decision in *Seymour* v. *Spring Forest Cemetery Association, supra,* as well as the case of *Glenwood Manufacturing Co.* v. *Syme, supra,* again without distinguishing between solvent and insolvent debtors.

Is it not extremely improbable that the various New York courts, which have spoken on this subject, would not have mentioned the distinction between solvent and insolvent corporations if this made any difference in the rule expounded by them?

Nor did Referee Olney, Judge Goddard or Judge Swan find any basis for the distinction between solvent and insolvent corporations which petitioner proposes. The fullest discussion of this subject is to be found in Judge Swan's opinion (R. 183). He there points out that:

> "It is not immediately apparent why insolvency should make a difference. It will cost the debtor no more whether the dividend which it may be able to pay creditors goes to the original holder of the debt or to a director-assignee."

There Being No Overruling Federal Law Here, the Questions Here Presented Are to Be Determined by Reference to New York State Law Which Clearly Sanctions the Transactions Here Involved.

We have already pointed out at page 49 of this brief that Mr. Justice Frankfurter, in his concurring opinion in the *Vanston* case, *supra,* went on to emphasize that the laws of the forty-eight states governing commer-

al transactions cannot be and are not to be wiped out hen a corporation is adjudicated a bankrupt and that ongress never intended any such result.

Since there is no overruling Federal law proscribing e transactions approved by the lower courts, the rule revailing in the State of New York, enunciated in *Seymour v. Spring Forest Cemetery Association, supra*, must overn.

Although petitioner argues at page 41 of its brief, hat "federal law controls the distribution to creditors n bankruptcy", it overlooks that there is—to use the language of this Court in the *Vanston* case—no "overruling ederal law".

The various decisions upon which petitioner relies for ts erroneous contention that there is a prevailing Federal aw or rule which proscribes the transactions here under onsideration, are all clearly distinguishable. What they old is that in the administration of an estate in bankruptcy "a local rule governing the liquidation of insolvent estates" will not be permitted to interfere with the method of distribution to creditors prescribed by the Bankruptcy Act."

Thus, in the case of *Prudence Realization Corp. v. Geist*, 316 U. S. 89 (1942), this Court refused to follow State law only for the reason that this law was found to e one "governing the liquidation of insolvent estates which was wholly at variance with the express provisions of the Bankruptcy Act."

In *American Surety Company v. Sampsell*, 327 U. S. 269, (1946), this Court sustained the order of the Referee subordinating the claim of the surety company because this was what State law required.

In *Heiser v. Woodruff*, 327 U. S. 726 (1946), the only point involved was whether a judgment of the State court would be regarded as *res adjudicata* in the Bankruptcy Court where it was shown that the Trustee in Bankruptcy had appeared in the State court proceeding and had taken

part therein. This Court held that the principle of *res adjudicata* would be applied.

Since petitioner and the Securities and Exchange Commission also rely heavily on the decision of this Court in *Pepper* v. *Litton*, 308 U. S. 295, it seems proper that we should point out that, in this Court's later decision in *Securities and Exchange Commission* v. *Chenery Corp.*, 318 U. S. 80 (1942), where the *Pepper* case was discussed, the prevention of fraud was held to measure the scope of the doctrine which the *Pepper* case was supposed to lay down. This Court then stated, in its discussion of the *Pepper* case, that it dealt merely with the question of whether claims obtained by the controlling stockholders of a bankrupt corporation were to be treated equally with the claims of other creditors where the evidence revealed "a scheme to defraud creditors reminiscent of some of the evils with which 13 Eliz. c. 5 was designed to cope". Although the *Chenery* case, when it came before this Court for the second time (332 U. S. 194) following a remission of the matter to the Securities and Exchange Commission, was decided adversely to the purchasers of the stock, nothing said in the second opinion of this Court affected its previous appraisal and interpretation of the rule laid down in *Pepper* v. *Litton*.

Certainly, nothing said in any of petitioner's authorities just reviewed justifies the position taken by petitioner on this appeal that in every bankruptcy case the question of what claims are to be allowed to share in the distribution is to be decided according to what the Bankruptcy Court in that particular case deems equitable—judged by its own standards and conceptions of equity—and that prevailing State law may be totally disregarded if it is contrary to what that particular Bankruptcy Court considers fair and proper. On this strange theory, every Bankruptcy Court would become vested with law making and rule making power that would run beyond anything heretofore known. Every District Court could apply its

own peculiar notions of equity—whether these conflict with the notions of other District Courts or with long established doctrines of the State Courts in that jurisdiction. There could never be any certainty or definiteness on any question and soon there would result the utmost confusion and chaos.

But even assuming for the sake of argument that the notions of petitioner are correct, it must be obvious that we do not have one body of equitable doctrines in the Federal courts and an entirely different body in the State courts. In the absence of a Federal statute, the Bankruptcy Courts, even if they have the right to allow or disallow claims on purely equitable considerations, must assess and appraise these considerations on the basis of the decisions of the highest State Courts in the jurisdictions where they are sitting. No other rule would be tolerable. The New York Courts have never regarded the purchase of securities by directors of a corporation as being wrong in principle, or otherwise objectionable, and this is true whether the corporation is solvent or insolvent.

POINT III.

Even if the insolvency rule pressed by petitioner does exist, it should not be applied in the case of a corporation which, though technically insolvent in the bankruptcy sense, is nevertheless a going concern.

Judge Goddard, in his opinion in the District Court, to which we have already referred (R. 94-95), pointed out that both under New York State law and even under the Federal decisions

> "directors and those who occupy a similar position may acquire the unmatured obligations of a going concern and enforce the same for the full face amount if such purchase is fair to the corporation

and involves no competition with the corporation * * *."

In addition to the cases which we have already cited, he referred to several others in support of his conclusion, viz. *Moore Constr. Co.* v. *U. S. Fidelity & Guarantee Co.*, 293 N. Y. 119, 125; *Ingelhart* v. *Thousand Islands Hotel*, 32 Hun 377; *Oelberman* v. *N. Y. & Northern R. Co.*, 14 Misc. 131.

Reviewing the authorities relied upon by petitioner where it was held that officers, directors and attorneys of a corporation may not—while the corporation is insolvent—purchase claims against it at a discount and then enforce such claims in a bankruptcy proceeding at their full face value, Judge Goddard pointed out that:

> "However, these cases do not seem to cover a situation where the corporation, although insolvent in a bankruptcy sense, is still a 'going concern' for the mere fact that a corporation is insolvent does not dissolve the corporation and make the directors mere trustees of its assets if it is still a 'going concern'. *White, Potter & Paige Mfg. Co.* v. *Pettes Importing Co.*, 30 Fed. 864; *Contra Costa Water Co.* v. *City of Oakland*, 113 P. 668, 682, 159 Cal. 323; *Public Market Co. of Portland* v. *City of Portland*, 130 F. (2nd) 624, 646, 171 Or. 522; *Michigan Wolverine Student Co-op* v. *Wm. Goodyear & Co.*, 22 N. W. 2nd, 884, 888, 314 Mich. 580. This distinction as to the duty of a director when the corporation, although insolvent is a going concern, was recognized in *Sanford Tool Co.* v. *Howe, Brown & Co.*, 157 U. S. 312; see *Asheville Lumber Co.* v. *Hyde*, 172 Fed. 730, 733."

We respectfully submit that even if, contrary to the uniform current of authority in New York State and in

the Federal courts sitting in New York, it should be held that so-called Federal law requires the recognition of the insolvency test here relied upon by petitioner, that doctrine should be held not to apply to a going concern.

Not only does the rule expressed by Judge Goddard accord with common sense and the elementary requirements of everyday business transactions, but it contains a definitely ascertainable standard of conduct which can be readily applied. It will be easy to enforce the sanctions imposed by the limitation doctrine when the proscribed purchases have been made after the corporation has ceased to be a going concern. There will never be any serious controversy as to when a corporation is a going concern and when it is not. When a corporation has closed down and has ceased doing business and paying its bills, it has entered upon a period of demise. While it maintains its property and assets and meets its bills—whether promptly or slowly is immaterial—it is still a going concern and there always exists the possibility of improvement and rehabilitation. Especially is this the case when the corporation is engaged in the real estate business and its solvency or insolvency depends upon market trends and currents in the real estate field.

Moreover, the rule expressed by Judge Goddard makes sense. While a corporation is a going concern there is no reason whatever to forbid directors from purchasing its securities when they think these are unduly depressed. First, such purchases insure a market for other security holders who do not want to or are unable to hold on to their holdings. Secondly, the purchase of such securities furnishes a powerful incentive to directors to work for the improvement and rehabilitation of their corporation because, if they are successful, they will reap a profit. To rob directors of going concerns which may be temporarily embarrassed of such a powerful incentive strikes us as being in the highest degree unwise. It is unnecessary and it would serve no possible purpose. If, as we

have previously pointed out, directors in the acquisition of debt securities overstep the mark and violate their fiduciary duties, they can always be called to account. Adequate safeguards therefore exist to prevent inequitable conduct by directors.

The instant case furnishes perhaps the best illustration that can be found of the force and validity of our contentions. As the Findings show, and as Judge Swan pointed out in his opinion, the conduct of the directors in this case was "obviously very beneficial to those debenture holders who retained and have proved their bonds in the arrangement proceeding" (R. 180). Unquestionably, this "obviously very beneficial" conduct was induced by the hope that this would enable the directors and the respondents to make their holdings of the debenture bonds more valuable and give them a profit on their investments.

If any such rule as petitioner argues for had existed during the critical years when the bonds here involved were being acquired, there would manifestly have been no possible incentive for the directors to even attempt to keep the debtor corporation alive or for the respondents to risk the monies which they advanced on the second mortgage and the taxes. Certainly, the hope of making a profit on the bonds which they purchased supplied a powerful motive to keep the debtor out of bankruptcy. None of the other security holders of the debtor corporation, large or small, were willing to put up one penny. And all of the other directors, who also held substantial quantities of the bonds, sought only to get rid of their holdings at any price they could get so that, as one of them put it, they would not have to attend the "funeral" of the debtor corporation.

How, then could the application of any such strict and rigorous rule as petitioner contends for have served any useful purpose in the case of a going concern like the debtor? Such a rule would only have defeated any pos-

ble chance of salvaging anything for the debenture
olders here, and instead of the 43.61% which those who
eld on received, there would have been a total loss to all.
t will be recalled that the respondents, who advanced
15,000 on the second mortgage through their Baset Cor-
oration for the purpose of staving off foreclosure of the
rst mortgage by the Poughkeepsie Savings Bank in 1943,
onorably refrained from foreclosing this second mort-
age when it went into default, and indeed advanced ad-
itional moneys for taxes, amounting to about $8,000. It is
uite clear that they would not have done so if they did
ot own some of the securities of the debtor corporation.
acking such ownership, there would have been no incen-
ve whatever to withhold foreclosure of their second mort-
age. Because such incentive did exist, everybody bene-
ted. And this is as it should be. Barring highly the-
retical arguments about the potential conflict in interest,
o one in the practical realms of business life can see any
eal or genuine danger in permitting directors to pur-
hase the debt securities of their corporation even if the
alue of the corporation's property falls below the lia-
ilities at any stage—so long as the corporation is able
o keep going and still has the prospect of being able to
ork out of its temporary difficulties. By giving directors
ome freedom of action and choice and affording them an
pportunity to make a profit on securities which they pur-
hase fairly while conditions seem bad, directors will act
ith courage and vision and, in the end, all the security
olders will benefit.

POINT IV.

The argument of petitioner and the Securities and Exchange Commission that purchases after insolvency by directors must be forbidden because such purchases are fraught with potential conflicts of interest is purely theoretical and without support in the actual experience of the business world. Moreover, any such rule is too vague and uncertain to be capable of enforcement, and there exists neither statutory nor judicial sanction for any such extreme position.

Petitioner studiously avoids any argument as to why a different rule should apply in the case of purchases of securities of insolvent corporations from that applying in the case of solvent corporations. Nor does petitioner present any reasonable or workable formula from which it could be determined how and when, in the case of a going corporation like the debtor, which managed to struggle through 13 years of existence and pay in full all of its current obligations as well as its mortgage indebtedness, directors desiring to buy the debtor's securities are at any given moment to determine whether the corporation is solvent or insolvent.

We have already discussed this matter at length at pages 9 to 11 of this brief and we have yet to find in any of the briefs submitted either by the petitioner or the Securities and Exchange Commission any answer to the practical questions and problems which inevitably must arise when an attempt is made to apply the suggested rule to such a case as the instant case or the *Wade Park Manor* case, *supra.*

The nearest that petitioner comes to any discussion of the merits of its contention here under review is at pages 20 and 21 of its brief where it makes some casual comment to the effect that "the impact of insolvency throws

upon the director the urgent duty of considering what steps are to be taken to protect the best interests of his corporation, its stockholders and its creditors"; and that "the conduct of directors, who are buying an insolvent corporation's debt securities at depressed prices, may make a substantial difference one way or the other to the corporation and its creditors." Petitioner goes on to ask:

> "What is to prevent directors from taking a certain line of action, or none at all, until they have corralled all of the debt securities they can? The directors of an insolvent corporation, faced with all the problems that insolvency creates, must keep themselves in a position where there will be no conflict of interest between their position as creditors and the welfare of the entire community of interests in the corporation. Claims which directors may have acquired when the corporation was solvent may, of course, present some conflict of interest once the corporation has become insolvent; but where after insolvency has occurred directors make purchases of claims they are deliberately creating the conflict."

This argument of petitioner follows in its entirety the contention advanced by the Securities and Exchange Commission in its brief *amicus curiae* filed in the Court of Appeals. The argument then made by the Commission was that "insolvency by its very nature places the corporation in the field to settle its indebtedness" and that any purchase of debt securities made from that time on by a director "is fraught with potential conflicts of interests".

First, it is to be observed that this same argument was advanced by the Securities and Exchange Commission to

this Court in the first *Chenery* case, 318 U. S. 80. There, too, the Commission emphasized that

> "the effect of trading by management is not measured by the fairness of individual transactions between buyer and seller, but by its relation to the timing and dynamics of the reorganization which the management itself initiates and so largely controls."

These contentions, however, did not impress the majority of the Court. Thereafter, the Commission again urged this same point of view in several other cases, including the *Wade Park Manor* case, but also without success.

Next, though the Commission urged that after insolvency "potential conflict cannot be avoided", the Commission has failed to present a single specific case where this supposed conflict actually arose. It is, of course, an easy matter to make a theoretical argument on any subject and it is a very simple thing to say that "potential conflict cannot be avoided" when insolvency ensues. More than bare assertions, however, are required to support such a novel viewpoint. The only clue that has ever been given as to just what potential conflict the Commission sees in the acquisition of securities after insolvency is the one mentioned in its brief in the Court below. There the Commission argued that since the acquisition of debt securities at a substantial discount may lead directors to postpone institution of proceedings under the Bankruptcy Act, without reference to the interests of the corporation, until they have had an opportunity to acquire the distressed securities, they should be forbidden in advance from ever getting into such a position. The Commission went on to acknowledge that a similar conflict of interest could exist in some situations where the corporation was technically solvent, but it offered no suggestions or proposals for dealing with that contingency. Certain it is that if the

foundation for the doctrine now pressed by the Commission rests upon the fear that directors of an insolvent corporation will postpone resorting to bankruptcy in order to corral all the debt securities they can, such fear is completely groundless. Common experience shows that the surest way to corral in the debt securities of an insolvent corporation at depressed prices is to plunge the corporation into bankruptcy or reorganization—not to keep the corporation running as a going concern. It certainly seems a naive view that directors will postpone bankruptcy in order to buy securities of their corporation more cheaply than they could acquire them after bankruptcy. If any actual case of that character ever existed, it is strange that the Commission has refrained from bringing it to the attention of the Court.

It surely must be of the utmost significance that no one except the Commission has thus far been able to discern the potential conflict just discussed. Up to the present moment, neither the Legislature of the State of New York nor Congress has sensed any such potential conflict and enacted statutory provisions to prevent it. Nor have the courts of New York State, which undoubtedly have more frequent occasion to deal with such matters than the courts of any other state, apprehended the existence of any such potential conflict. On the contrary, the Court of Appeals in the *Seymour* v. *Spring Forest* case, *supra*, thought that any rule prohibiting the purchase of the debt securities of a corporation by its directors while the corporation was a going concern would

> "crowd the rule almost to the verge of an absurdity, and to inflict a vital injury upon business interests by tainting with invalidity the holding by a director of the unmatured obligations of the corporation bought by him in the open market and not put in liquidation or sought to be extinguished."

And the able and experienced Federal judges in the Second Circuit who have had occasion to deal with this same question, some in the instant case and some in the other cases which we have cited, have also failed to apprehend the supposed danger that lurks in the continuance of business practices that have been going on without question or challenge for generations.

The Supreme Court of Wisconsin, in the case of *Glenwood Manufacturing Company v. Syme*, 109 Wis. 355, where the president and a director of a corporation acquired obligations of such corporation at a discount during a period when the corporation was "embarrassed and without funds to pay pressing demands" dismissed a suit brought against this president for an accounting of the profits which he had made and in its lengthy opinion made a critical analysis of the very doctrine which petitioner and the Commission expound here. In disapproving such doctrine, the Court pointed out that since there was no duty resting upon the president to extinguish the corporation's obligations and the corporation was obviously in no position to discharge these, there could be no conflict of duty which would prevent the acquisition of the corporation's obligations by the president for his own account.

Where Congress found on the basis of actual experience that some prohibition with respect to trading in the securities of an insolvent corporation was necessary, it did not hesitate to act (Sections 212 and 249 of Chapter X).

In a recent article published in the Harvard Law Review of June, 1949 (Vol. 62, No. 8) which reviewed the decision of the lower court in the instant case, the learned author after expressing his accord with such decision and after criticizing the so-called insolvency restriction, went on to make the following trenchant and sage observations:

"Moreover, since the general rule allowing directors to make such purchases is based on a choice in favor of allowing directors to have a stake in the corporate enterprise in spite of the danger that they will take unfair advantage of investors, it seems illogical to prevent directors from purchasing corporate obligations when the corporation is insolvent. That is the very time when such purchases may be of most benefit to the corporation, since the credit of the corporation may be improved if it is known that directors are purchasing the corporation's securities; also it may be possible to forestall a bankruptcy petition while the corporation improves its financial position. Cf. *Monroe* v. *Scofield,* 135 F. 2d 725 (10th Cir. 1943); see W. Fuller, *Restrictions Imposed by the Directorship Status on the Personal Business Activities of Directors,* 26 Wash. U. L. Q. 189 (1941). Thus it may be hoped that the present case indicates a trend away from the irrational insolvency restriction."

What responsible persons will ever agree to accept appointment as directors of such a corporation as the debtor corporation if they can never, during the continuance of the technical state of insolvency which petitioner claims existed, manifest their confidence in their ability to extricate the corporation from its difficulties by acquiring some of its securities for their own account. As we have already mentioned, if the argument of petitioner and the Commission in this case is pressed to its logical conclusion, none of the directors in this case nor their friends could ever have acquired any of the debentures because the debtor corporation was insolvent at the very beginning of its existence and at all times thereafter remained insolvent within the definition pressed by petitioner.

Buying orders, whether placed by insiders or outsiders, tend to support the market and enable investors who want

to get out and not assume any further risks to do so. Why should such orders be discouraged? No one need sell unless he wants to.

The Insolvency Restriction Doctrine Upon Which the Petitioner and the Securities and Exchange Commission Rely Is Unsound in Principle and Has Thus Far Failed to Receive Judicial Approval.

Neither the petitioner nor the Securities and Exchange Commission have undertaken to explore the genesis nor defend the rationale of the doctrine which they press upon this Court growing out of the insolvency restriction rule. Both have simply assumed that there is such a restriction and that it is a sound one.

In the dissenting opinion of the Court below, Judge Learned Hand likewise speaks of the books being full of declarations "that an insolvent holds his property in trust for his creditors" and that when the insolvent is a corporation whose directors were fiduciaries as to shareholders, they become double fiduciaries of the creditors on insolvency.

An examination of the decided cases, however, reveals that there is grave doubt that this insolvency restriction doctrine has any actual basis in the law. As the learned author of the article in the Harvard Law Review, to which we have previously made reference, points out:

> "It is generally held that a director of a solvent corporation may purchase corporate obligations at a discount and later enforce them for the face amount. See Ballantine, Corporations 209 (rev. ed. 1946). The present case (*Calton Crescent, Inc.*) extends this rule by rejecting the frequently stated restriction that a director may not enforce such obligation if the corporation was insolvent at the time of purchase. See 3 Fletcher, Cyclopedia of

Corporations §869.1 (repl. vol. 1947). This insolvency restriction has grown out of the theory that the assets of an insolvent corporation become a trust fund for creditors. See *In re Philadelphia & W. Ry.*, 64 F. Supp. 738, 740 (E. D. Pa. 1946). But the Supreme Court has refuted the idea that there is an actual trust relationship upon insolvency, *Hollins v. Brierfield Coal & Iron Co.*, 150 U. S. 371, 385 (1893), and it has been pointed out that the assets can be said to be a trust fund only by 'analogy and metaphor.' See 4 Pomeroy, Equity Jurisprudence §1046 (5th ed. 1941). The federal cases supposedly applying the insolvency restriction in fact involved a breach of duty by directors either because they were under a duty to acquire the obligations for the corporation, *e. g.*, *In re McCrory Stores Corp.*, 12 F. Supp. 267 (S. D. N. Y. 1935) (insolvent corporation was actively trying to settle its obligations), or because they had been appointed trustees in bankruptcy and so could make no profit. *In re Philadelphia & W. Ry., supra.*"

This Court, in the case of *Hollins v. Brierfield Coal & Iron Co.*, 150 U. S. 371 said, speaking upon this trust fund doctrine (p. 385):

"These cases negative the idea of any direct trust or lien attaching to the property of a corporation in favor of its creditors, and at the same time are entirely consistent with those cases in which the assets of a corporation are spoken of as a trust fund, using the term in the sense that we have said it was used. * * *

A party may deal with a corporation in respect to its property in the same manner as with an individual owner, and with no greater danger of being held to have received into his possession property

burdened with a trust or lien. The officers of a corporation act in a fiduciary capacity in respect to its property in their hands, and may be called to an account for fraud or sometimes even mere mismanagement in respect thereto; but as between itself and its creditors the corporation is simply a debtor, and does not hold its property in trust, or subject to a lien in their favor, in any other sense than does an individual debtor. That is certainly the general rule, and if there be any exceptions thereto they are not presented by any of the facts in this case. Neither the insolvency of the corporation, nor the execution of an illegal trust deed, nor the failure to collect in full all stock subscriptions, nor all together, gave to these simple contract creditors any lien upon the property of the corporation, nor charged any direct trust thereon."

In the recent opinion filed by Special Master Friebolin in the *Matter of Wade Park Manor Corporation, supra,* which we have discussed, he pointed out that much of the confusion respecting the duties and obligations of directors arises from the failure to recognize the nature of the fiduciary relationship. We quote from the learned Special Master's opinion:

"The law seems to be that a director's relation to his corporation is that of a fiduciary with rather strict duties as to loyalty; that, altho he is a fiduciary in his relation to *stockholders,* he may ordinarily buy and sell its stock, except under special circumstances of unfairness in the particular transaction.

No contention is here made that a director of a corporation *at all times* sustains a fiduciary relation to *creditors;* it is claimed that upon 'insolvency' the director becomes such fiduciary, particularly insolvency in the bankruptcy sense.

If that be conceded, we still have the question in that particular fiduciary relationship, what are the duties and responsibilities of a director towards creditors; the beneficiaries? Is it the strict rule applicable to express trustees? Are they bound by the strict rule of undivided loyalty in all circumstances, regardless of good faith and honest dealing? Or are they bound by the less rigid rules: good faith, fair dealing and no inequitable conduct conflicting with a present duty to the corporation or to creditors?

The objectors in the case before us contend that, once the corporation is insolvent in the bankruptcy sense only, directors become, in effect, express trustees; any dealing in claims of creditors is a violation of the strict duty of loyalty; good faith, honest intentions, no suppression of facts to the sellers who offered their securities for sale for the public to buy, has any relevance. The fact that this insolvency existed for fourteen years before proceedings were instituted and that such claims (bonds and Land Trust Certificates) were bought and sold by public brokers for many years at the market price, it is said, has no relevance."

The Securities and Exchange Commission filed a brief with Special Master Friebolin in which it advanced the same arguments that are advanced here. Commenting upon these arguments, the learned Special Master said that while they possessed "no little force" he could not find that the Courts have gone so far as to apply the extreme doctrine urged. He said:

"I cannot find that the courts have gone so far as to apply to the fiduciary relationship of a director as to creditors, that of à strict trustee; nor even to hold that, as a fiduciary of creditors merely

because the corporation at the date of purchase by him of claims against the corporation was insolvent in the bankruptcy sense, he is then accountable within the strict rule of an express trustee.

It must be kept in mind always, of course, that even tho a director be not bound by the strict rules of a trustee; even tho he might conceivably not be found to be a 'fiduciary', the Bankruptcy Court may nevertheless in the exercise of its equitable jurisdiction, sift the circumstances surrounding any claim to see that injustice or unfairness is not done in the administration of an estate. Particularly where the court finds a person to occupy a fiduciary position, his claim may, upon equitable grounds, be subordinated or limited. The Supreme Court has on several occasions announced this rule."

It will be obvious from the foregoing that much of the confusion respecting the duties and obligations of directors arises from the failure to recognize the nature of the fiduciary relationship. If a director occupies the position of an express trustee so that he is strictly forbidden under any circumstances to purchase the unmatured obligations of his corporation when it is insolvent in a bankruptcy sense, his liability with respect thereto is then absolute and all questions of good faith, fair dealing, or conduct hostile to the interests of the corporation and its creditors, become irrelevant. No reported decision has ever so held. (See decision of Judge Patterson in *Ripperger* v. *Allyn*, 25 Fed. Supp. 554, at p. 555.) On the other hand, if the fiduciary duty of a director, after insolvency in the bankruptcy sense, rests upon the equitable principles governing constructive trusts, then the accountability of a director is not absolute but depends upon whether the purchases were made under circumstances

hich in the conscience of equity may be regarded as unust enrichment.

Thus, the nature of a director's fiduciary duty—whether is governed by the rules applicable to express trusts or e rules applicable to constructive trusts—is basic to the ecision here on appeal and is basic to a clarification of e law. With respect to this fundamental question, to old that a director is in effect an express trustee, absent ny manifestation of corporate intent to make him such, ould be contrary to the well established rules governing xpress trusts. It would create a violent disturbance in e common practices of business. In many cases, as ere, it would result in the unjust enrichment of other reditors who have suffered no injury. Where purchases f unmatured bonds of a going concern were made by a rector long before bankruptcy proceedings, it would resent difficult questions of fact as to the fair value of e corporate assets at the time of the purchases and ould present difficult questions of fact as to the time hen bankruptcy insolvency occurred and as to whether ich insolvency was continuous to the date of the bankuptcy filing. The alternative is to hold that in the case f all claims by a director the right to participate ratably bankruptcy proceedings depends upon a determination at the director was not guilty of fraud, bad faith or inquitable conduct conflicting with any present duty to his rporation, its creditors or stockholders; and as an examination of the cases shows, this has been the practice tually followed by the Federal Courts, despite the occaonal language in some of the cases ambiguously characterizing the position of a director as that of a trustee, hile at the same time relying upon the powers of the ankruptcy Court to distribute the estate acording to its vn equitable rules, as announced by this court in *Pepper Litton*, 308 U. S. 295, and subsequent cases.

We shall later consider the authorities relied upon by e petitioner and the Securities and Exchange Commis-

sion. We think it will be clear from our review that wherever the insolvency restriction was applied, the corporation involved has ceased to function as a going concern and there existed actual breaches of duty on the part of the directors. If that is so, then, these cases manifestly furnish no authority against the decision here under appeal.

The Application of the Insolvency Restriction Doctrine to the Case of a Going Concern Would Be Opposed to Common Sense.

Finally, it is to be observed that even if the Commission's viewpoint has any substance or force, it can only be in relation to a business that has for all practical purposes been shut down and is virtually in process of liquidation—not to a going concern like the debtor which continues to retain its property and carry on its business and meet its current obligations. Such a going concern—even if technically insolvent, stands, from every practical standpoint, in no different position than a solvent business. As has already been pointed out, the debtor's issue of debenture bonds did not mature until September 27, 1953, and no interest was payable thereunder unless earned. There was, therefore, no need for the directors of the debtor corporation to deal with the problem of paying or composing this bond issue until the property had been sold and determination made as to whether sufficient remained to pay the bonds off in full. That did not occur until 1946. Until then the debtor stood in the same position as any solvent corporation. It operated its business and paid its bills—though sometimes late, and it retained ownership of its sole asset. Indeed its situation was constantly improving, due to the fact that construction of new housing had stopped during the War and inflation was on the wing. At no time up to an actual sale could the question of whether it was insolvent or solvent be

strated objectively, and no need ever arose to deal hat problem until the sale which took place in 1946. inly, the petitioner and the Commision have failed ighten the Court as to where and when the sup- potential conflict of interest, of which they speak, in the instant case. If the Commission's argument nd that this arose on insolvency, then two difficul- t once present themselves. The first is that the ration was born insolvent and the second is that r legal nor practical insolvency could be spelled out the mere fact that the debtor's property could not times here material have been sold in the market price sufficient to pay all the debts. At times, there no market even for the choicest properties, and cannot be sold at anything except distress prices. however, does not mean that the owner of the prop- vho is meeting all his current obligations and carry- arges has become insolvent in any practical sense at a duty immediately rests on him to consider the ation of some kind of debtor proceeding.

POINT V.

any aspect of the matter, the unanimous opinion ex- d by the Referee, the District Judge and all three s of the Court of Appeals, that the purchases made e respondents from other directors of the company d not be subject to any limitation rule, is sound and d be affirmed by this Court.

ne extremes to which the petitioner goes in its con- ns is best exemplified by its insistence that even on ecurities acquired from other directors, the respond- should be deprived of any profit. On this point the ee and all of the Judges who have sat on the in- case are fully agreed that no rule of law or prin-

ciple of equity or controlling decision warrants or justifies any such holding. Even Judge Learned Hand, in his dissenting opinion said (R. 188):

> "I should not include any bonds bought by a director from a director; surely they stand on an equality."

We have already reviewed at page 7 of this brief the negotiations which led up to the sale by the former directors and officers Kelly, Hays, Clay, representing the Y. W. C. A.) and Minor (representing the King Estate) of their holdings, and we have shown that these parties, without solicitation and entirely on their own initiative, bargained with the respondents to purchase their securities from them so that they could completely terminate all connection with the debtor corporation. That these other directors had full and complete knowledge of the affairs and operations of the debtor corporation was overwhelmingly established (F. 44, 45, 47, 50, 51, R. 76-77), Respondents' Exhibits 7, 8, 9, 10, 11, 16, 17, 22, 23, 24, 25b, 25e, 29, R. 146-163). And even petitioner concedes, at page 13 of its brief, that all of these other directors knew that they were selling their bonds to respondents.

In view of the foregoing, it is impossible to fathom what rule of equity petitioner claims was violated by respondents in purchasing these securities from the other directors two years before bankruptcy. It certainly cannot be argued that these directors, men of eminence and standing in the financial and legal world, were imposed upon or overreached or that they did not know what they were doing. None of them came forward on the trial of this case and made any such complaint. Petitioner, however, does gratuitously suggest at page 13 of its brief that these directors may not have been informed of the inquiries and offers which were being received for the real

tate. Strange it is that petitioner called none of these rectors as witnesses to prove this unjust assumption. oreover, petitioner ignores the holdings in all of the inions in the courts below, including the dissenting opin- of Judge Hand, that the petitioner's case broke down mpletely so far as it rested upon the suppression of any formation with regard to the value of the property.

Certainly, if the rule of law contended for by the titioner is so strict that it even bars directors of a rporation from selling to other directors or friends or embers of the families of these other directors, it would ach the point of absurdity and injustice. No wonder titioner has refrained from advancing the least argu- ent to support this extreme claim on its part. That y such claim is completely devoid of merit seems to be early established (*Bisbee* v. *Midland Linseed Products* ., 19 Fed. [2d] 24, [C. C. A. 8, 1927]; *DuPont* v. *Du- nt*, 256 Fed. 129 [C. C. A. 3, 1919]).

POINT VI.

None of the cases cited by petitioner or the Securities d Exchange Commission are applicable and all of them ll within the well recognized exceptions to the general le.

The authorities relied upon are: *In re Van Sweringen ompany*, 119 Fed. (2d) 231 (6 Cir. 1941); *In re Norcor anufacturing Co.*, 109 Fed. (2d) 407 (7 Cir. 1940); *Mon- e* v. *Scofield*, 135 Fed. (2d) 725 (10 Cir. 1943); *In re os Angeles Lumber Products Co. Ltd.*, 46 Fed. Supp. 77). C. S. D. Cal. 1941); *In re Jersey Materials Co.*, 50 ed. Supp. 428 (D. C. N. J. 1943); *Philadelphia* v. *West- n Ry. Co.*, 64 Fed. Supp. 738 (D. C. E. D. Pa. 1946); *re McCrory Stores Corporation*, 12 Fed. Supp. 267). C. S. D. N. Y. 1935); *Ripperger* v. *Allyn, et al.*, 25

Fed. Supp. 554 (D. C. S. D. N. Y. 1938); *Bulkley* v. *Whitcomb,* 121 N. Y. 107 (1890); *Bramblet* v. *Commonwealth & Lumber Co.,* 26 Ky. L. Rep. 1176 (1904); *Bonney* v. *Tilley,* 109 Cal. 346 (1895).

When these cases are analyzed, they will all be found to fall within one of the well recognized exceptions to the rule applied below which permits directors to buy securities of their corporation—whether solvent or insolvent—and to prove their claims for the full face amount of such securities.

Referee Olney in his opinion pointed out (R. 79) that there exist certain well recognized exceptions to the rule of law which he applied in favor of the respondents. These exceptions relate to cases (1) where a special fund has been provided by the debtor corporation to pay the obligation; (2) where a special liquidation has been ordered through the institution of receivership or kindred proceedings; (3) where the debtor was in the field to settle its own obligations; (4) where the acquisition of the obligation by the director was unfair to the debtor and involved competition with it; and (5) where the director is guilty of overreaching by unfairly using his special knowledge in dealing with those from whom he acquired the obligations.

Judge Goddard, in his opinion in the District Court, also recognized the existence of these exceptions (R. 94-95).

The principal authority relied upon by petitioner and the Commission is, of course, *In re Van Sweringen Company, supra.* The facts of this case, as given by petitioner at pages 22-23 of its brief, are wholly inadequate. What was there involved was a reorganization under former §77-B. The debtor corporation had pledged virtually all of its assets with J. P. Morgan & Co. to secure loans exceeding $39,000,000 in amount, for which promissory notes were given to the said pledgee. These notes went into default and the Morgan Company gave notice

at it would sell the collateral at auction. By that time, f course, the debtor corporation had completely ceased oing business as a going concern. The Van Sweringen rothers, who were officers and directors, designing to cquire control of the pledged assets for themselves and freeze out all of the creditors of the corporation, conived with two individuals named Ball and Tomlinson to rm a corporation known as the Midamerica Corp., which ould buy in these pledged assets at the auction sale at ridiculously low price. This was successfully accomlished and then the Midamerica Corp. proceeded to file a aim in the reorganization proceeding for the face amount f the notes which it had acquired at the auction sale nducted by the pledgee, Morgan & Co. The grossly agrant character of the transaction was marked by the ct that although the Midamerica Corp. had on its own ooks allocated only $1.00 of the price paid on the auction le for the note of the debtor corporation in the amount f $8,177,023.99 and had allocated only $887 as the cost f another note in the face amount of $13,787,000, and 2.00 as the cost of a still further note of the debtor's ubsidiary, Cleveland Terminals Building Company, in the nount of $1,348,614.99, it nevertheless proceeded to file aims against the debtor corporation for the full face nount of these large obligations,—and this notwithanding the fact that it had already acquired at the sale l of the collateral security which was deposited to secure ese obligations. This same Midamerica Corp, it deeloped, had agreed by contract to give the Van Swerinen Bros. a ten year option to acquire 55% of the stock the Midamerica Corp. at cost, plus 5% interest, and so agreed to pay them a salary of $100,000 a year. The t result of the transaction, as the Court pointed out, as that without investing a penny the Van Sweringen ros., who as officers and directors of the debtor corpoation occupied a fiduciary relationship to their creditors, me out of the affair with complete voting control of the

Midamerica Corp. for ten years; a $100,000 annual s
ary, and an option to buy 55% of the stock of the Mi
america Corp. for $8,250.

Certainly, the attempt not only to retain the pledg
securities of the debtor corporation purchased at the au
tion sale but to file for the full face amount of the debtor
notes which were secured by these pledged securities, w
a shocking performance which no court could countenan
It was a fraud which a Bankruptcy Court had full pow
to deal with not only under the provisions of former Se
tion 77-B, but also under the inherent power to preve
fraud recognized in *Pepper* v. *Litton*, 308 U. S. 295. T
Court, citing the *Pepper* case as authority, pointed o
that what the Midamerica Corp. did was "within the i
hibited area of bargaining not conducted at arm's leng
as defined in *Pepper* v. *Litton*." The Court went on
say that it was apparent "that the cupidity of persons
a fiduciary position has caused them to serve themselv
in preference to those whom it was their duty to serve

Manifestly, the facts in the instant case are whol
dissimilar from the facts in the *Van Sweringen* case.
the very outset we find in the *Van Sweringen* case a pu
chase of assets of the debtor corporation—not mere
debt securities. It was the collateral securing the debtor
notes which was offered for sale at auction and which t
Van Sweringen Brothers bought in through their cre
ture, Midamerica Corporation. Next, the Van Swering
Brothers, who, as officers and directors, owed the highe
degree of loyalty to their creditors, persuaded Ball a
Tomlinson to join with them in violating their fiducia
obligations in a manner which would yield a profit to bo
Contrast that situation with the instant case where
assets of the debtor corporation were involved in the se
eral purchases (but only debt securities) and where no
of the directors had any financial interest in the secu
ties acquired. Furthermore, whereas in the *Van Swer*
gen case the purchases were made after the corporati

had ceased doing business and its assets were being sold under the hammer, and when an insolvency proceeding was obviously imminent, the purchases in the instant case were made while the corporation was functioning normally as a going concern and the purchases were made months and years before the arrangement petition was filed.

An excellent discussion of the decision in the *Van Sweringen* case is to be found in the opinion of Special Master Friebolin in the *Wade Park Manor* case. He there said in part:

> "The objector and the Securities & Exchange Commission rely upon the *Van Sweringen* case (6 C. A. 41) 119 F. 2d 231. They claim that in this case the Court applied to directors the strict rule applicable to Trustees, that is, undivided loyalty which does not take into account good faith and fair dealing or the rules of unjust enrichment applicable to persons other than express trustees who are fiduciaries. The claimants herein, on the other hand, insist that the Court did no such thing; that it found fraud and lack of good faith.
>
> I am inclined to agree with the claimants. It should not be overlooked that the Court of Appeals decided several separate proceedings in one opinion. These originated with a report by a Special Master to the District Court followed by a decision and opinion by that Court upon each of the said reports. I have read the Master's Reports, both opinions by Judge Jones, in which he approved one Report by Special Master Russo—in which the claim was disallowed—and disapproved the other Master's report by Mr. Woods—in which the claim was allowed.
>
> After reading the two opinions by Judge Jones and the opinion of the Court of Appeals, I am quite

convinced that the court did not apply the rule contended for by the objectors to the effect that the directors of a debtor became trustees for creditors merely upon the bankruptcy insolvency of the debtor, with the duty of undivided loyalty applicable to strict trustees so that good faith to, and fair dealing with, creditors is immaterial, and that the rules of unjust enrichment found by inequitable conduct, are entirely irrelevant.

There are many statements in the two opinions of the District Judge and of the Court of Appeals, which seem to indicate quite clearly that there was found bad faith and inequitable conduct by directors of the debtor which the Court, within exercise of its equitable powers, regarded sufficient to make Midamerica (the corporation organized at the instigation of the directors for the purpose of purchasing the notes and bonds of the debtor and the subsidiary debtor) a constructive trustee of the property."

In the case of *In re Norcor Manufacturing Co., supra*, the claims against the bankrupt corporation were purchased not only by Kreuger, the principal stockholder and director, but also by his attorney Lehner, as well as by Lehner's wife. All these claims so purchased were then reassigned to a corporation whose board of directors were controlled by Kreuger and Lehner. The claims were purchased after the bankrupt corporation had already confessed insolvency in the Court, and they were acquired in contemplation of an impending reorganization.

Clearly, this *Norcor* case falls within one of the well recognized exceptions to which we have referred. The purchase was made ten months after an insolvency proceeding had been started in the State court and the Court found that the conduct of Kreuger and his attorney was fraudulent.

The case of *Monroe* v. *Scofield, supra,* also falls within one of the well recognized exceptions. The purchase attacked was made by a director after bankruptcy and the Court held that this could not be done except "by an order of the Court" and then not unless Monroe had "been shorn of all power in the corporate management and his trust relationship has been fully terminated".

The case of *In re Los Angeles Lumber Company, Ltd., supra,* also falls within one of the well recognized exceptions. An excellent statement of what this case really held is to be found in the report of Special Master Friebolin in the *Wade Park Manor* case. He there said:

> "In the *Los Angeles Lumber* case directors and their attorney purchased most of the bonds of their corporation after the filing of a reorganization petition, but a few, also, before such filing. But the latter were purchased *after the Board of Directors of the debtor corporation had authorized the filing of such petition* and while the debtor was insolvent —apparently both in the bankruptcy and equity meaning, altho the court doesn't say so. The court regarded the reorganization (was) *really in process at the time* and limited the allowance to cost of acquisition. As appears from the opinion, the Court relied, also, on the general equitable powers of the Bankruptcy Court to limit, disallow or subordinate claims to prevent injustice and unfairness, especially when a fiduciary relation exists—regardless of the rules applicable to strict trustees. After a court takes possession of the debtor's property the strict rule applicable to express trustee seems to be enforced—certainly where the debtor is in possession."

It is also interesting to note that the decision of the Federal District Court in the *Los Angeles Lumber* case

was based upon two California decisions cited by the Court at page 88, thus indicating that the Court was applying a rule of local application.

In its discussion of the facts in the *Los Angeles Lumber* case, petitioner at page 28 of its brief mentions that the "early purchases were made before any reorganization proceedings were pending". But petitioner fails to mention that such purchases were made after the Board of Directors had authorized the filing of the petition; when the corporation was no longer a going concern, and when insolvency both in the bankruptcy and equity sense existed.

The case of *In re Jersey Materials Co., supra,* also falls within one of the well recognized exceptions. The purchase by the President and his dummy was made when bankruptcy was not only imminent but in contemplation. In the language of Special Master Friebolin, who discusses this case in his report, "the court expressly found that the director did *not* fairly execute the duties of his trust; he *anticipated dissolution* of the corporation and knew that the mortgage could be bought at a bargain and *failed to communicate it* to the corporation.

The case of *Philadelphia* v. *Western Ry., supra,* also falls within one of the well recognized exceptions. The purchases were made after a 77-B reorganization proceeding had been initiated and during the period when the debtor corporation was in possession under orders of the Court. The Court pointed out that "directors holding office under court appointment or court approval become in all respects, so far as their fiduciary obligations are concerned, the full equivalent of a trustee in bankruptcy."

The cases of *In re McCrory Stores Corporation,* and *Ripperger* v. *Allyn, supra,* have already been discussed at pages 48 and 49 of this brief. The limitation which was enforced in the *McCrory* case was under the scrutiny clause of former §77-B (11 U. S. C. A. §207 [b]). Judge Patterson found that there had been a violation of fiduciary

obligation on the part of Hedden who, while he was a director of the debtor corporation, obtained information with respect to the various leases and the claims of landlords arising thereunder, which information he utilized immediately upon his resignation. The *Ripperger* case arose on a motion to dismiss the complaint but the Court explicitly pointed out the immunity doctrine does not apply where the failure of the debtor company to buy up the claims for itself was brought about because the directors wished to acquire them for themselves.

The case of *Bulkley* v. *Whitcomb*, *supra*, is completely inapplicable, as we show on page 50 of this brief.

The case of *Bramblet* v. *Commonwealth & Lumber Co.*, *supra*, is also a case falling within one of the recognized exceptions. The Court there found that at the time of the purchase of the judgment by the President, acting in collusion with another, the corporation "was a derelict and its assets salvage". The Court found bad faith, collusion and violation of fiduciary obligation.

The case of *Bonney* v. *Tilley*, *supra*, involved an effort on the part of directors of an insolvent corporation, who were creditors, to obtain a preference over other creditors by buying up some judgments against the corporation for nominal amounts. The Court said:

> "It seems to be well settled that directors of an insolvent corporation, who are creditors of the company, cannot secure to themselves any preference or advantage over other creditors in the payment of their claims."

5

POINT VII.

There is no authority for the filing of a limitation proceeding by one creditor to reduce the claim of another creditor in an arrangement proceeding under Chapter XI.

Admittedly, there is nothing in Chapter XI which authorizes the filing of a limitation proceeding to reduce claims to amounts paid therefor. This is readily understandable when we consider the nature of a Chapter XI proceeding, which is nothing but a substitution for the old type of composition under former §12 of the Bankruptcy Act. That, as was pointed out by Judge Leibell in the case of *In re Vulcan & Reiter Co.*, 8 Fed. Supp. 286 (S. D. N. Y.), "in effect" was "a contract between the debtor and his creditors by which he obtained a settlement of their claims against him by paying an agreed sum into court for distribution to such creditors by order of the court. * * * The rights of the debtor and the creditors became fixed as of the date of confirmation, and nothing more remained to be done but the distribution of the fund."

This same view was taken by this Court in the case of *Nassau Works v. Brightwood Co.*, 265 U. S. 269 (1924), at page 271, and by the Court of Appeals for the Second Circuit in the case of *Equitable Holding Corporation v. Woody*, 63 Fed. (2d) 751 (1933).

Since, in the case of a composition, the contract of the debtor is to pay to the creditor an agreed sum in settlement of the latter's claim, it is obvious that creditors have no standing to file objections to the claims of other creditors and that only the debtor would have such right. There is no reported case that we have been able to find where, in the old fashioned composition proceeding under §12, or in an arrangement proceeding filed pursuant to Chapter XI, creditors have been permitted to come into

ourt and limit the claims of other creditors, so that they ght obtain an increased dividend beyond what the btor agreed to pay. It is surely significant that Coness, although writing a limitation provision covering aims and stock into the provisions of Chapter X yet iled to do so in Chapter XI. Petitioner has advanced explanation or argument touching upon this significant nission. And even in Chapter X, the only statutory anority for a limitation proceeding is to be found in §212. at this section appears to confine the power of the Court limit claims in a corporate reorganization proceeding claims or stock acquired by a committee, indenture istee, attorney, or agent acting under or proceeding der a power or warrant of attorney, trust mortgage, ust indenture, or deed of trust. Certainly, therefore, en if the instant case was a reorganization proceeding ed under Chapter X, it is doubtful that petitioner's mon for limitation of the claims of the respondents would proper—absent, of course, fraud or wrongdoing cogzable under the doctrine of *Pepper* v. *Litton*, *supra*. As matter of fact, all of the cases relied upon by petitioner, here limitation proceedings have been entertained,—with e exception of *Monroe* v. *Scofield*, 135 Fed. (2d) 725 943), and *In re Jersey Materials Co.*, 50 Fed. Supp. 428 943)—will be found to be reorganization cases either der Chapter X or former §77-B. The *Monroe* and *rsey Materials* cases were both ordinary bankruptcy oceedings involving flagrant violations of fiduciary duty officers or directors of the bankrupt corporations, hich were committed, in the one case, while bankruptcy as pending in the court, and in other case in contemplan of bankruptcy.

In short, there is no statutory authority or judicial pinion—state or federal—which justifies the limitation oceeding in this case.

Manifestly petitioner is proceeding on the assumption at a Bankruptcy Court had inherent power as a Court

of Equity to limit claims in any kind of a bankruptcy or reorganization proceeding. The question immediately arises: Why, if the Bankruptcy Court has inherent power to limit claims, was it necessary to legislate express power so to do in Chapter X and to confine such power to the specific situation dealt with in §§212, 249.

The case of *Vanston Bondholders Protective Committee v. Green*, 329 U. S. 156 (1946), is cited by petitioner to support the view that the Bankruptcy Court has power to limit the allowance of claims in a manner that would "be compatible with the Bankruptcy Act." It is, of course, true that this language was used and that at a later part of the opinion this Court when on to say that Bankruptcy Courts "must administer and enforce the Bankruptcy Act as interpreted by this Court in accordance with authority granted by Congress to determine how and what claims shall be allowed under equitable principles." However, in this very same opinion, the Court pointed out that:

> "What claims of creditors are valid and subsisting obligations against the bankrupt at the time a petition in bankruptcy is filed is a question which, in the absence of overruling federal law, is to be determined by reference to state law."

CONCLUSION.

It is respectfully submitted that the order appealed from should be in all respects affirmed.

Dated, New York, October 13, 1949.

Respectfully submitted,

David W. Kahn,
Counsel for Respondents.

INDEX

In the Supreme Court of the United States

OCTOBER TERM, 1948

No. 742

MANUFACTURERS TRUST COMPANY, AS TRUSTEE UNDER AN INDENTURE MADE BY THE DEBTOR UNDER DATE OF SEPTEMBER 27, 1933, AND INDIVIDUALLY, PETITIONER

v.

REGINE BECKER, EMILY K. BECKER, AND WALTER A. FRIBOURG

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION, AMICUS CURIAE, IN SUPPORT OF THE PETITION

OPINIONS BELOW

The opinion of the court of appeals (C. 8–25)[1] has not yet been reported. The opinion of the district court (A. 116–122) is reported at 80 F. Supp. 822.

---

[1] For convenience, we use the same designations to the record as petitioner. "C" refers to part C of the transcript filed in this Court. "A" refers to part A of the transcript, being the appendix to petitioner's brief as appellant below.

JURISDICTION

The judgment of the court of appeals was entered on March 3, 1949 (C. 26). The petition for a writ of certiorari was filed on April 20, 1949. The jurisdiction of this Court is invoked under 28 U. S. C. 1254.

QUESTIONS PRESENTED

1. May a director who has purchased claims against his corporation for a fraction of their face amount during the insolvency of the corporation be permitted to profit thereon in a proceeding under the Bankruptcy Act subsequently initiated by the debtor?

2. Assuming that distribution to a director in the above situation would be limited to cost, does a different rule apply where the purchases were made (a) in the sole discretion of the director acting as agent for his wife and mother, or (b) with the assistance of the director by his office associate?

STATEMENT

In view of the adequacy of the statement in the petition, we omit a separate statement.

ARGUMENT

1. The questions which have arisen here in the context of a Chapter XI proceeding are of importance in the over-all administration of the Bankruptcy Act, and particularly Chapter X thereof in which this Commission has a statutory

interest. The decision below is in conflict with principles which have been applied in other circuits and tends to encourage lax fiduciary standards inconsistent with the basic purpose of the Act.[2]

A major objective of the reforms in reorganization practice embodied in the Chandler Act was to prevent abuses whereby "the financial well-being of investors and the public" was "sacrificed to the insiders' desires for protection and for future profit."[3] In our view fulfillment of this ob-

---

[2] The cases cited in notes 4 and 8, *infra*, indicate that the questions involved here have been recurrent in the lower courts, where they have generally been decided contrary to the decision below. At the present time these questions are involved in several Chapter X reorganizations to which this Commission is a party: purchases by a fiduciary during insolvency of the company are involved in *In re Drake Stadium and Field House Corp.*, No. 9758 (S. D. Ia.); family relationships are involved in *In re Equitable Office Building Corp.*, (S. D. N. Y., Jan. 7, 1949), appeal pending in C. A. 2; and in *In re Chicago Rapid Transit Co.*, No. 65,037 (N. D. Ill.); both of these issues are involved in *In re Wade Park Manor Corp.*, No. 64,870 (N. D. Ohio); and in *In re Franklin Building Company*, unreported, No. 25,907 (E. D. Wis., Dec. 23, 1948), appeals pending in C. A. 7.

[3] H. Rep. No. 1409, 75th Cong., 1st Sess., p. 37 (1937). No provision of the Act deals specifically with the consequences of action by officers and directors in breach of their fiduciary duties, but the principle of subordination or limitation of claims is inherent in the powers of a court of bankruptcy as a court of equity. See *Pepper v. Litton*, 308 U. S. 295. Provisions of the Act which do deal with breach of fiduciary relationship in other contexts specifically recognize the appropriateness of the sanction of limitation to cost. *Cf.* Section 212 which expressly authorizes the judge to "limit any

jective requires that fiduciaries be precluded from realizing any profits in a bankruptcy proceeding from transactions which have created a conflict between their self-interest and discharge of their fiduciary obligations. The decision below concedes the application of this principle to purchases by fiduciaries themselves in the course of the reorganization (C. 18–19). We believe that similar considerations apply to purchases during the critical period when a corporation is insolvent, whether or not there has been a determination to resort to bankruptcy proceedings, and also to transactions entered into by close relatives or business associates of a fiduciary with his knowledge and assistance.

2. In our view the occurrence of insolvency, irrespective of the pendency or imminence of the bankruptcy proceeding, creates a sufficient crisis in the corporate affairs to make applicable different rules than are applicable to ordinary corporate operations. Upon insolvency it clearly becomes the duty of the corporation through its directors to consider appropriate measures for

---

claim or stock acquired by" a trustee or agent or committee "in contemplation or in the course of the proceeding under this chapter to the actual consideration paid therefor." Similarly, Section 249 provides for disallowance of compensation for services to persons who have traded in securities affected by the reorganization after assuming to act as fiduciaries in a proceeding. Section 249 has been held declaratory of equitable principles which go beyond its express provisions. See *In re Midland United Co.*, 159 F. 2d 340 (C. A. 3).

ehabilitation or for equitable distribution of he corporation's assets among its creditors. Whether the interests of the corporation and its ecurity holders will best be served by a debt djustment through negotiation or by proceedngs under the Bankruptcy Act or other insolvency statutes should be determined without eference to the self-interest which the securities purchase program of a director would motivate. The self-interest of insiders engaged in a program of purchasing securities of their insolvent corporation may conflict with their fiduciary obigations not only with respect to the character of the disclosures they may make as to the possibilities of salvaging the situation but also with respect to the timing and scope of their salvage efforts, whether by way of informal negotiations with creditors or by institution of proceedings under the Bankruptcy Act.

These considerations support the rule which has been expressed broadly that purchases by directors while the corporation is insolvent should be imited to cost. We believe that the court below erred in limiting this rule to the situation where the purchases were actually made during reorganization or where reorganization was in actual contemplation of the directors, as distinguished from the situation where the directors are either endeavoring on behalf of the corporation to settle with the creditors out of court or merely considering the possibility of instituting

proceedings under the Bankruptcy Act.[4] Realistically these possibilities will normally overlap and that, in effect, creates the basic problem of conflict of interest.[5]

---

[4] As pointed out by the majority below (C. 19, n. 11), in some cases enunciating the limitation-to-cost rule for claims purchased by directors during insolvency of the company the purchases were actually made "after some type of bankruptcy proceeding was pending or was imminent and known to be so by the director. *Monroe* v. *Scofield*, 10 Cir., 135 F. 2d 725, 726; *In re Philadelphia & Western Ry. Co.*, 64 F. Supp. 738, 739 (E. D. Pa.); *In re Los Angeles Lumber Products Co.*, 46 F. Supp. 77, 82 (S. D. Calif.)." In these cases, however, the decision was not rested on either of those grounds. Moreover, in other cases enunciating the same rule, the purchases were made a full year prior to the filing of a voluntary petition, *In re The Van Sweringen Co.*, 119 F. 2d 231 (C. A. 6), certiorari denied *sub nom. Terminal & Shaker Heights Realty Co.* v. *Van Sweringen Co.*, 314 U. S. 671, *Gochenour* v. *Cleveland Terminals Building Co.*, 142 F. 2d 991, 992 (C. A. 6), certiorari denied, 323 U. S. 767, and five months before the filing of an involuntary petition, *In re Jersey Materials Co.*, 50 F. Supp. 428 (D. N. J.), and there is no indication in these cases that any judicial proceeding was contemplated by the directors at the time of the purchases. *Cf. In re Norcor Mfg. Co.*, 109 F. 2d 407 (C. A. 7), certiorari denied, 310 U. S. 625, where the purchases were made during a period commencing two and one-half years prior to the filing of an involuntary petition, but during a state court receivership.

[5] We recognize that conflicts of interest in the purchase of debt securities of a corporation by its directors could occur in some situations even where the corporation is solvent, for example, when the directors of a corporation realize that insolvency will necessarily occur in the near future unless measures are taken to adjust its debt. The courts, however, have generally used insolvency as a rule-of-thumb to mark the situation where such potential con-

In our opinion the necessity for limiting to cost the participation of directors on claims acquired during insolvency but prior to the reorganization of the debtor may be even greater than when claims are acquired during the course of the reorganization. During reorganization the debtor and its assets are under the jurisdiction of the bankruptcy court; management decisions are subject to the approval of the bankruptcy court and are made in many cases by an independent trustee; and in most instances the participation of a director in the affairs of the company is of a formal nature. Before reorganization, on the other hand, the director occupies a strategic position, since he actively participates in the management of the corporation, and where the corporation is insolvent his determinations may, as we have shown, greatly affect the interests of the debtor and its security holders.

The court below refused to limit respondents to cost because, *inter alia,* it could not find that the creditors who did not sell to respondents were

---

flict cannot be avoided and have generally applied equitable limitations to directors' claims purchased during solvency only where some overreaching or injury to the corporation can be shown, since normally there is no conflict "in the ordinary case of the purchase by a director in a going corporation of its outstanding obligations." *Seymour* v. *Spring Forest Cemetery Association*, 144 N. Y. 333, 344, 39 N. E. 365 (1895); see also *In re Philadelphia & Western Ry. Co.*, 64 F. Supp. 738, 739–740 (E. D. Pa.).

"wronged."[*] This observation would be equally relevant to purchases during the course of the reorganization, where the court conceded that the limitation to cost doctrine is applicable (C. 18–19), and it emphasizes what we believe is an unduly narrow view of the duty of an equity court to prevent profits from breach of duty. In any event, as pointed out by Chief Judge Learned Hand in his dissent (C. 22):

> * * * if equity regards the bonds as improperly acquired, it is more nearly just to distribute any profits among the other creditors, who have not been paid in full, than to leave them in the director's hands; for they are a part of the bankrupt's assets and the creditors have a better claim to them than the director himself.

Irrespective of whether there may have been "overreaching" with respect to the debenture holders who sold to the respondents, the corporation was wronged when its directors, as its fiduciaries, placed themselves in a position where they

---

[*] The majority opinion states (C. 19) that "if a wrong has been done to any of the group of cestuis, it is to those who sold their claims at a price less than the dividend they would have received had they retained them." Yet the sellers, "if they were suing for the wrong done them, * * * would have to show something equivalent to a fraudulent non-disclosure. *Strong* v. *Repide*, 213 U. S. 419." It concludes that if the "unwronged cestuis" are to share in the profit, "it can only be as a disciplinary measure against the director for wronging someone who has not complained of the wrong," a sanction they were unwilling to impose in the absence of overreaching of the sellers.

could not act with an eye single to its interests; hence the directors should not be permitted to profit on a distribution of its assets.[7] Moreover, as a practical matter, the burden of enforcing the insiders' duty of undivided loyalty should not be left solely to security holders who have sold claims to them. The sellers are often not in a position to bring suit, and when they do, as indicated by the court below, they are subject to difficult burdens of proof.

3. The decision of the court below opens new avenues of evasion of equitable limitations applicable to a fiduciary by holding that these limitations do not apply to close relatives or business associates of a fiduciary who act with his knowledge and assistance. This ruling is clearly of substantial importance in the field of bankruptcy and corporate reorganizations.

The majority of the court below held that if equitable principles require the limitation to cost on claims purchased by directors during insolvency irrespective of any overreaching of the sellers, nevertheless proof of overreaching would be necessary in order to apply this limitation to the claims of the wife and mother of a director who acquired the debentures for them, even where these ladies "exercised no independent judgment

---

[7] See cases cited in n. 4, *supra*. See also *Bramblet* v. *Commonwealth Land and Lumber Co.*, 26 Ky. L. Rep. 1176, 83 S. W. 599, 602 (1904), and *Pepper* v. *Litton*, 308 U. S. 295, 306–307.

in the investment of their funds" (C. 21). The majority also indicated that in any event the claim of an office associate of directors, who apparently was supplied by them with the list of debenture holders, should be allowed in full. The court apparently attributed no significance to the fact that all three claimants had been instrumental in securing control of the debtor by these directors through participation in loans to the debtor at the directors' request (A. 89-90 C. 13).

Concededly, not every associate or relative of a director should necessarily be subject to the same equitable limitations as the director himself. The problem of allowing legitimate transactions by such individuals without inviting circumvention of the limitations upon directors and other fiduciaries can best be worked out on a case-by-case basis. However, the decision below lays down a general rule which requires a showing that the insider's associate or relative "knowingly confederates" in a breach of trust, which is interpreted as something more than acting upon a tip received from the insider. Thus, even where the court below assumed that the insider himself would be limited to cost, the holding is that his relatives and close business associates are free to utilize the insider's special information and advice and assistance in the transaction free of any such disability, at least in the absence of a conventional showing of "overreaching" such as

would warrant a suit for rescission by the seller (C. 21).[a] As such, the decision below may well serve as a precedent for permitting fiduciaries to do indirectly what they may not do directly, and thus has consequences far beyond the immediate problem of trading while the corporation is insolvent and prior to the institution of proceedings.

CONCLUSION

The decision below is inconsistent with the basic policy of the Bankruptcy Act and with the principles applied by other courts of appeals in interpreting the Act; it raises issues of substantial and recurring importance in the field of bankruptcy and corporate reorganizations. The petition for certiorari should be granted.

Respectfully submitted.

PHILIP B. PERLMAN,
Solicitor General.

ROGER S. FOSTER,
General Counsel,
Securities and Exchange Commission.

May 1949.

---

[a] For contrary holdings, see *In re Midland United Co.*, 159 F. 2d 340, 347 (C. A. 3); *In re Midland United Co.*, 64 F. Supp. 399, 416–417 (D. Del.); *In re Equitable Office Building Corporation*, (S. D. N. Y., Jan. 7, 1949); see also *Holman* v. *Ryon*, 56 F. 2d 307, 311 (C. A. D. C.); *In re Inland Gas Corp.*, 73 F. Supp. 785 (E. D. Ky.); *In re Fulton's Will*, 253 App. Div., 494, 2 N. Y. S. 2d 917 (1938); *Gunther* v. *Gove*, 275 Mass. 235, 175 N. E. 464 (1931); *cf. In re Los Angeles Lumber Products Co.*, 37 F. Supp. 708 (S. D. Calif.).

U. S. GOVERNMENT PRINTING OFFICE 1949

INDEX

CITATIONS

Cases:

Cases—Continued

In the Supreme Court of the United States

October Term, 1949

No. 55

Manufacturers Trust Company, as Trustee under an Indenture Made by the Debtor under Date of September 27, 1933, and Individually, petitioner

v.

Regine Becker, Emily K. Becker, and Walter A. Fribourg

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION, AMICUS CURIAE, IN SUPPORT OF PETITIONER

INTRODUCTORY STATEMENT

Although this appeal arises under Chapter XI of the Bankruptcy Act, the Commission is submitting this brief as *amicus curiae* since it is of the opinion that the determination of the questions involved herein will have an important bearing on

similar questions arising under Chapter X of the Bankruptcy Act in proceedings to which it may be a party.[1]

OPINIONS BELOW

The opinion of the court of appeals (R. 175-188) is reported at 173 F. 2d 944. The opinion of the district court (R. 91-95) is reported at 80 F. Supp. 822.

JURISDICTION

The judgment of the court of appeals was entered on March 3, 1949 (R. 189). The petition for a writ of certiorari was filed on April 20, 1949, and granted on June 6, 1949 (R. 189). The jurisdiction of this Court is invoked under 28 U.S.C. 1254.

QUESTIONS PRESENTED

1. May a director who has purchased claims against his corporation for a fraction of their face amount during the insolvency of the corporation be permitted to profit thereon in a proceeding under the Bankruptcy Act subsequently initiated by the debtor?

2. Assuming that distribution to a director in the above situation would be limited to cost, does a

---

[1] At the present time, questions similar to those presented here are involved in several Chapter X reorganizations to which this Commission is a party; purchases by a fiduciary during insolvency of the company are involved in *In re Drake Stadium and Field House Corp.*, No. 9758 (S.D. Ia.); family relationships are involved in *In re Chicago Rapid Transit Co.*, No. 65,037 (N.D. Ill.); both of these issues are involved in *In re Wade Park Manor Corp.*, No. 64,870 (N.D. Ohio); and in *In re Franklin Building Company*, 83 F. Supp. 263 (E.D. Wis.), appeals pending in C.A. 7.

different rule apply where the purchases were made (a) in the sole discretion of the director acting as agent for his wife and mother, or (b) with the assistance of the director by his office associate?

STATEMENT

The facts are set forth in the briefs filed by the parties. For purposes of this brief, we note merely that the court below found that the debtor, Calton Crescent, Inc., was insolvent during the entire period when the purchases of the claims involved here were made—a four-year period preceding the filing of the voluntary petition under Chapter XI of the Bankruptcy Act; that the purchases of the respondents Regine and Emily K. Becker (the mother and wife, respectively, of a director) were made with their own funds by the director without these ladies' exercising any independent judgment in the investment; that the purchases made by respondent Fribourg, office associate of the directors of the debtor, were made with his own funds upon information furnished by the directors; that in all of these purchases there was no evidence of any wrongful overreaching or concealment; and that all of the securities acquired as a result of these purchases were allowed to participate without limitation, on a parity with the holdings of public security holders.

ARGUMENT.

I

A Director Who Has Purchased Claims Against His Corporation for a Fraction of Their Face Amount During the Insolvency of the Corporation Cannot Profit Thereon in Proceedings under the Bankruptcy Act Subsequently Initiated by the Debtor [2]

The prevailing rule in the federal courts, with which the decision below in our view conflicts, is that during the insolvency of a corporation its directors and officers may not profit by trading in claims against the company.[3] The court below did not directly repudiate this rule but, by reason of what we believe to be a misapprehension of its purpose, has grafted onto the rule an unwarranted exception. The exception would limit the application of the rule, in cases where the purchases occurred prior to the commencement or imminence

---

[2] Although there are no claims filed in this case by directors which were purchased during the insolvency of the corporation and which would therefore be subject to the rule limiting participation on such claims to cost in subsequent bankruptcy proceedings, it is necessary to establish this proposition in order to determine the ultimate question involved herein whether the rule should be held applicable to the claims of the wife, mother and office associate of the director.

[3] *In re Norcor Mfg. Co.*, 109 F. 2d 407, 411 (C.A. 7), certiorari denied, 310 U.S. 625; *In re The Van Sweringen Co.*, 119 F. 2d 231, 234 (C.A. 6), certiorari denied *sub nom. Terminal & Shaker Heights Realty Co.* v. *The Van Sweringen Co.*, 314 U.S. 671; *In re Los Angeles Lumber Products Co.*, 46 F. Supp. 77 (S.D. Cal.); *In re Jersey Materials Co.*, 50 F. Supp. 428 (D. N.J.); *Pepper* v. *Litton*, 308 U.S. 295, 311; *Woods* v. *City National Bank and Trust Co.*, 312 U.S. 262, 268-269; *Monroe* v. *Scofield*, 135 F. 2d 725 (C.A. 10); *In re Philadelphia & Western Ry. Co.*, 64 F. Supp. 738 (E.D. Pa); *In re McCrory Stores Corp.*, 12 F. Supp. 267, 269 (S.D. N.Y.).

of bankruptcy proceedings, to situations where there is proof of overreaching or concealment by the director, or where there is a showing of injury either to the corporation or the selling creditors. This exception appears to derive, in part, from a conception that the rule is solely related to the protection of selling security holders against their management.

In our view, however, the ultimate purpose of the rule is to prevent fiduciaries from placing themselves in a position where they may be tempted to violate their obligation of undivided loyalty.[4] Its immediate objective is to prevent the directors from trading in its corporate obligations when, because of insolvency, they are fiduciaries to all security holders of the corporation.[5] It is an application of the principle of the law of trusts which was set forth by this Court as follows in *Magruder* v. *Drury*, 235 U. S. 106, 119:

> It is a well settled rule that a trustee can make no profit out of his trust. The rule in such cases springs from his duty to protect the interests of the estate, and not to permit his personal interest to in any wise conflict with

---

[4] *Cf. Woods* v. *City National Bank and Trust Co.*, 312 U.S. 262, 268. There are other doctrines, remedial in nature, as illustrated by *Strong* v. *Repide*, 213 U. S. 419, and *Taylor* v. *Standard Gas & Electric Co.*, 306 U.S. 307, which are designed to give relief to parties injured by overreaching, concealment or mismanagement by fiduciaries and it is significant that these doctrines are applicable whether or not the corporation was solvent or insolvent when the breach of fiduciary duty occurred.

[5] *Pepper* v. *Litton*, 308 U.S. 295.

> his duty in that respect. The intention is to provide against any possible selfish interest exercising an influence which can interfere with the faithful discharge of the duty which is owing in a fiduciary capacity.

The court below recognized but failed, we believe, to make a realistic application of that principle. A director clearly owes to an insolvent corporation a duty to take whatever steps may be necessary best to protect its security holders. These steps may well be inconsistent with what would be most advantageous for a director acquiring the debt securities of the corporation. As an insider, he is in an unique position to assess the value of the claims against the corporation and if the market should assess this claim at a lower value, he may find it advantageous, for example, to adopt measures to stave off bankruptcy proceedings so that he can continue his purchase program. The immediate institution of proceedings, however, might be in the best interests of the debtor's security holders, since it might release the corporation from onerous contracts or otherwise prevent its assets from being wasted. The broad area of "business judgment" in which a director may act and the impossibility of proving what might have resulted had different steps been taken [6] normally make it impossible to show that a director intentionally sabotaged his

---

[6] *Cf. Taylor* v. *Standard Gas & Electric Co.*, 306 U.S. 307, 323.

corporation to achieve a personal gain—and indeed, in a particular case it might appear in the light of hindsight that the action of the director has turned out in the best interests of the security holders of the corporation. This possible coincidence, however, is insufficient protection for the insolvent corporation's security holders who are entitled to have their fiduciaries act without being influenced in any respect by considerations as to their own personal advantage or disadvantage.

Contrary to the holding below, we believe that there is no sound distinction between purchases during the period when bankruptcy proceedings are "contemplated" and during the period of insolvency preceding such contemplation. The court below apparently used the term "contemplated" to apply to situations where a decision has already been reached to institute the proceedings or at least the individual fiduciary expects that action to be taken after a contemplated meeting of the board of directors. It should be noted, however, that in a very real sense reorganization proceedings necessarily are contemplated from the moment that insolvency occurs because that is clearly one of the few possibilities open to the corporation. It is at this time that the directors must become concerned not only with the normal running of the corporation but also with the steps necessary for rehabilitation or for equitable distribution of the corporate assets. Whether the interests of the corporation

nd its security holders will best be served by a ebt adjustment through negotiation or by proeedings under the Bankruptcy Act or other atutes should be determined without reference to ne self-interest which the securities purchase proram of a director would motivate.[7] Indeed, such ifferences as do exist between the period of inolvency preceding bankruptcy and the period when ankruptcy proceedings are pending actually make more essential that the rule be applied during the ormer period. After proceedings are instituted ne court becomes the guardian of the debtor's afairs and the corporation and the entire communy of interests it represents have the protection of idicial surveillance and supervision, which is ab-

---

[7] We recognize that it is possible for a director to be ibject to conflicting interests even when the corporation mains solvent, and similarly, a conflict of interests may rise after insolvency as a result of purchases of securities ade prior thereto. These dangers have never been regarded courts of equity as sufficient to justify a change in the ommon-law rule which permits directors to trade freely in e securities of solvent corporations so long as they indulge no overreaching or other fraudulent acts. See *Securities and rchange Commission* v. *Chenery Corp.*, 318 U.S. 80, *Strong* v. *epide*, 213 U.S. 419, and *Hotchkiss* v. *Fischer*, 136 Kan. 530, P. 2d 531 (1932). However, compare Section 16(b) of e Securities Exchange Act of 1934, 15 U.S.C. § 78p(b), hich, in recognition of the difficult problems relating to the fair use of inside information, categorically prohibits direcrs, officers and other "insiders" of corporations with listed curities from taking any profit on "quick-turn" transaction the equity securities of their corporation. In any ent, the fact that the rule has not been applied to iminate all of the potential temptations to divide his loyalty hich may arise for a director is no sound reason for limiting still further in a situation where it is clearly applicable.

sent during the period of insolvency preceding the institution of proceedings.

The only circumstance that the court below pointed to as indicating that the rule of limitation to cost should not be applied prior to the institution of bankruptcy proceedings or the "contemplation" thereof is the fact that most of the cases applying the rule involved claims purchased "after some type of bankruptcy proceeding was pending or was imminent and known to be so by the director." (173 F. 2d at 950.) None of these cases, however, made this an indispensable basis for invoking the rule, and the opinions uniformly state the rule in terms of insolvency.[8] Moreover, there are cases in which the rule has been applied where the claims had been purchased before bankruptcy proceedings were commenced, or contemplated in the sense that it had been determined to institute proceedings.[9] Indeed the rule has been applied where no bankruptcy or reorganization proceedings were ever involved. See *Bramblet* v. *Commonwealth*

---

[8] See cases in note 3, *supra*.

[9] *In re The Van Sweringen Co.*, 119 F. 2d 231 (C.A. 6), certiorari denied *sub nom. Terminal & Shaker Heights Realty Co.* v. *The Van Sweringen Co.*, 314 U.S. 671 (purchases made a full year prior to the filing of a voluntary petition, as indicated in related case of *Gochenour* v. *Cleveland Terminals Building Co.*, 142 F. 2d 991, 992 (C.A. 6), certiorari denied, 323 U.S. 767); *In re Jersey Materials Co.*, 50 F. Supp. 428 (D. N.J.), (purchases made five months before the filing of an involuntary petition). *Cf. In re Norcor Mfg. Co.*, 109 F. 2d 407 (C.A. 7), certiorari denied, 310 U.S. 625, where the purchases were made during a period commencing two and one-half years prior to the filing of an involuntary petition, but during a state court receivership.

Land & Lumber Co., 26 Ky. L. Rep. 1176, 83 S.W. 599, 602 (1904), where the court said:

> We have no hesitancy in declaring the law to be that a president of an insolvent and failing corporation cannot traffic in its property to his advantage and to its disadvantage, or buy in debts against it at heavy discount and then assert them for full value. To the argument that it does not matter to the corporation who owns its debts, so it honestly owes them, and that it is immaterial to it whether its president gets them for nothing, as it does not have to pay any more than it actually owes in any event, the answer is, it does matter, for human nature is not so constituted that the same person can fairly represent opposing sides of the same question—cannot be both creditor and debtor. The corporation was entitled to the untrammeled judgment and efforts of its president in administering its affairs in its behalf exclusively. When he assumed an attitude wherein his personal interest came into conflict with his duty to his corporation—where he would be tempted to serve it less diligently in order that he personally might profit by his relaxation of official vigilance—his disloyal act to his company will be turned aside from his pocket, and the profits of his speculation will be turned into the corporation. The policy of the law is to insure fidelity of trustees to their trusts by making it impossible for them to profitably neglect or abuse them. Whether the derelict officer acts from a mistaken notion of his

> rights, or from an actually fraudulent purpose, is immaterial, as affecting the invalidity of the transaction. The principle is too well settled to require elaboration.

Judges have frequently warned against the temptation to relax the rigidity of the rule that fiduciaries may not be permitted to profit where their personal interests may conflict with those of their cestuis in cases where the trustee has appeared to act in good faith and no damage to the cestui can be shown. As Judge Cardozo pointed out, these considerations constitute

> no sufficient answer by a trustee forgetful of his duty. The law "does not stop to inquire whether the contract or transaction was fair or unfair. It stops the inquiry when the relation is disclosed, and sets aside the transaction or refuses to enforce it, at the instance of the party whom the fiduciary undertook to represent, without undertaking to deal with the question of abstract justice in the particular case" [citing cases]. Only by this uncompromising rigidity has the rule of undivided loyalty been maintained against disintegrating erosion.[10]

Until the instant case, the decisions limiting directors to cost for claims purchased during insolvency considered irrelevant the questions whether the insider acted in good faith and whether the

[10] *Wendt* v. *Fischer*, 243 N.Y. 439, 443-444, 154 N.E. 303, 304 (1926). See also *Meinhard* v. *Salmon*, 249 N.Y. 458, 464, 164 N.E. 545, 546 (1928).

debtor suffered any injury—and, indeed, most of these cases gave no consideration to whether the insider committed any overreaching or concealment in acquiring the claims upon which he is permitted no profit. The decision below has subjected a salutary principle to the very kind of "disintegrating erosion" against which Judge Cardozo warned.

* * * * *

Although the Commission's primary co cern with the decision below is the effect which it may have upon current and subsequent proceedings under Chapter X of the Bankruptcy Act, to which it is a statutory party, we feel strongly that this equitable principle must be recognized as equally applicable in any kind of insolvency proceeding in the federal courts. Respondent urged below, unsuccessfully, and we presume will argue in this Court, that in a Chapter XI proceeding the federal court has no jurisdiction to invoke the limitation to cost rule. This Court has said that the power to subordinate or limit claims is inherent in the powers of a court of bankruptcy as a court of equity. *Pepper* v. *Litton*, 308 U.S. 295, 306, 307."[11]

---

[11] Provisions of the Act which do deal with breach of fiduciary relationship in other contexts specifically recognize the appropriateness of the sanction of limitation to cost. Cf. Sections 212 and 249 of Chapter X. It is clear that these provisions are not intended in any way to limit either the scope or the applicability of the broad equitable principles from which they are derived. See *In re Midland United Company*, 159 F. 2d 340 (C.A. 3); *In re Mountain States Power Co.*, 118 F. 2d 405 (C.A. 3); and *In re Los Angeles Lumber*

In addition, Chapter XI provides that when a voluntary petition is filed thereunder by the debtor, the court's jurisdiction, powers and duties shall be the same as if the proceeding were one in straight bankruptcy,[12] and this doctrine has been consistently applied by federal courts in straight bankruptcy proceedings. See *Monroe* v. *Scofield*, 135 F. 2d 725 (C.A. 10); *In re Jersey Materials Co.*, 50 F. Supp. 428 (D. N.J.). Moreover, under Section 366 the court is charged with the duty of determining that the arrangement is "fair and equitable" and accordingly, an arrangement which did not follow equitable principles of distribution should not be confirmed.

Products Co., 46 F. Supp. 77, 92 (S.D. Cal.). As was pointed out in the last cited case:

> Whether or not the specific language used in these sections [Section 77B, sub. b. and in Section 212 of Chapter X] is sufficiently broad to include the acts of Mr. Faries in the instant case, is beside the point. The very remedy provided in those sections has long been recognized and applied in the exercise of the general equitable power of the bankruptcy court. See *Bonney v. Tilley, supra* [109 Cal. 346, 42 Pac. 439 (1895)]; *In re Norcor Mfg. Co., supra. Cf. In re McEwen's Laundry, Inc.*, 6 Cir., 1937, 90 F. 2d 872.

And compare the state cases in which this rule has been recognized and applied as an incident of the courts' inherent equity power. *Bramblet* v. *Commonwealth Land & Lumber Co.*, 26 Ky. L. Rep. 1176, 83 S.W. 599 (1904); *Bulkley* v. *Whitcomb*, 121 N.Y. 107, 24 N.E. 13 (1890).

[12] See Sections 312 (2) and 322, Bankruptcy Act, 11 U.S.C. §§ 712, 722.

II

Where Claims Are Purchased During Insolvency by a Director Acting Within His Sole Discretion as Agent for His Wife and Mother, and by an Office Associate With the Assistance of the Director, Such Claims Must Be Treated as If the Director Had Purchased Them for Himself

We believe that the decision of the court below opens new avenues of evasion of equitable limitations applicable to a fiduciary by holding that these limitations do not apply to close relatives or business associates of a fiduciary who act with his knowledge and assistance. The majority below held that even on the assumption that the insider himself would be limited to cost, an extension of the limitation-to-cost rule would be required in order similarly to limit the claims of the respondents, because they "were not directors or officers of the debtor; their own funds were invested, and no officer or director of the debtor has any interest in the debentures they purchased" (R. 185).[13] The court

[13] In allowing the claims the court below relied strongly upon the decision in *In re Philadelphia & Western Ry. Co.*, 64 F. Supp. 738 (E.D. Pa.) in which the claims of McKernan, an officer of a corporation which had a management contract with the debtor, and Stoughton, the father of an officer of the debtor, were allowed without limitation. We disagree with the *Philadelphia and Western* case insofar as that case held that McKernan was not a fiduciary of the debtor despite her management contract and insofar as Stoughton was not held to have the burden of establishing that his son had not furnished him with any inside information or assistance. We do not, however, regard the *Philadelphia and Western* holding to be directly in point where there is an unquestioned fiduciary relationship and clear proof of advice and assistance by the fiduciary in the purchases by respondents. *Cf. In re Midland United Co.*, 64 F. Supp. 399, 416 (D. Del.).

then enunciated the general rule that claims of relatives and business associates should be limited only where it is shown that they have "knowingly confederated" in a breach of trust by the fiduciary.

Applying this doctrine to the instant case, the court held with respect to Fribourg, the business associate, that "investing one's own funds on a 'tip' received from an officer or director of a debtor" was not "knowingly confederating" with a fiduciary in a breach of trust (R. 185). As to the Becker ladies—the wife and mother of the director who acquired the debentures for them—the court found that although they are chargeable with the knowledge and equities of the director since they exercised no independent judgment in the investment of their funds, nevertheless the disciplinary sanction for "knowingly confederating" with a disloyal fiduciary should not be imposed since there was no overreaching of the sellers when the fiduciary made the purchase for his principals.

In our view this decision is inconsistent with the ultimate purpose of the limitation-to-cost rule and invites its circumvention by permitting the insider to utilize his special information, advice and assistance on behalf of relatives and close business associates.[14] To restrict the scope of the rule to cases

[14] An indication of how wide this avenue of evasion can become is illustrated by the facts in *In re Franklin Building Co.*, 83 F. Supp. 263 (E.D. Wis.), appeals pending in C.A. 7. In that case the claimants are the wife, daughter, and son of a fiduciary of the debtor and its bondholders. Purchases for the wife and daughter were made by the fiduciary while the

where associates and relatives have been guilty of "knowingly confederating" with a fiduciary in the sense used by the court below is to dilute greatly the deterrent effect of the rule. The holding serves as a precedent for permitting fiduciaries to do indirectly what they may not do directly, and, if applied in other cognate situations, could do much to thwart one of the major objectives of the reforms in reorganization practice embodied in the Chandler Act.[15]

As we have argued in Part I above, we conceive that the rule is designed to deter director-fiduciaries from placing themselves in a position where they may be tempted to violate their obligation of undivided loyalty when, because of insolvency, their fiduciary obligations are broadest. Similarly, therefore, it would seem that the basic determinant as to the application of this rule to purchases by

---

debtor was insolvent and during and subsequent to prior reorganization proceedings completely within his own discretion with funds belonging to the ladies. During the same period some of the son's purchases were made by the father and the remainder were purchased by the son entirely upon the father's judgment. Moreover, many of the bonds were purchased by the father and son with moneys which came from a single safe in the law and real estate offices shared by them. The district court limited the claims of the husband and father because he was a fiduciary but, adopting an attitude even narrower than the one reflected in the opinion below, allowed the claims of the son, wife and daughter in full.

[15] See H. Rep. No. 1409, 75th Cong., 1st Sess. p. 37 (1937), where it is stated that a major objective of the reforms was to prevent abuses whereby "the financial wellbeing of investors and the public" was "sacrificed to the insiders' desires for protection and for future profit."

relatives and business associates of the fiduciary after insolvency should be whether or not the "tendency to evil" at which the rule strikes exists in a given situation. The rationale underlying the application of the rule in such cases is not the imposition of sanctions or penalties for the personal misconduct of the persons presenting the claims. Rather, it is the recognition of the effect upon the fiduciary's motivation where he is left free to facilitate the realization of trading profits by close relatives and associates.

It is unrealistic and destructive to the operation of the limitation-to-cost rule to argue that the temptation for a fiduciary to be disloyal exists only when he has the kind of a financial interest which property or tax laws might recognize. There are many other equally compelling personal interests which, as a practical matter, produce fully as much pressure on trustees. This is especially true where the fiduciary's opportunity to make a direct profit from a diversion of loyalty is proscribed by well-settled principles of law.

Where a wife is involved, the nature and extent of the director's personal interests which are in conflict with the interests of his beneficiaries stand out most clearly. In view of the economic realities of American family life (which Congress has taken into recognition in the present income, gift, and estate tax laws) it is apparent that a husband has a financial interest, even though it may be in-

direct, in seeing his wife's separate estate increased. As stated in *In re Midland United Co.*, 159 F. 2d 340, 347 (C.A. 3), where an attorney was denied a fee from the estate because, among other things his wife traded in the securities of a subsidiary of the debtor in reorganization during the course of the reorganization:

> It will be noted that we have regarded Mrs. Evans' transactions as being in the same category as those of Mr. Evans. While she financed her securities dealings entirely with her own funds, Mr. Evans candidly stated that she engaged in the various transactions with his "entire approval and knowledge." Under such circumstances it is clear that the bankruptcy court was justified, in the exercise of its proper powers, in extending the principles applicable to the conduct of the fiduciary to the fiduciary's wife. The settled rule in equity is that where a fiduciary is barred from compensation the prohibition extends to his wife . . .[16]

In the instant case the circumstances are even stronger than in the *Midland* case where the purchases were made with the fiduciary's "entire approval and knowledge" (159 F. 2d at 347). Here the wife "exercised no independent judgment" in

---

[16] See also *Holman* v. *Ryon*, 56 F. 2d 307, 311 (C.A D.C.); *In re Inland Gas Corp.*, 73 F. Supp. 785 (E.D. Ky.); *In re Fulton's Will*, 253 App. Div. 494, 2 N.Y.S. 2d 917 (1938); *Gunther* v. *Gove*, 275 Mass. 235, 175 N.E. 464 (1931); *cf. In re Los Angeles Lumber Products Co.*, 37 F. Supp. 708 (S.D. Calif.).

the purchase of the bonds; they were purchased for her by the director (R. 185).

The purchases made for Becker's mother stand upon substantially the same basis, in relation to the policy of the rule, whether we look to expectation of inheritance, recognition of a moral obligation of support or merely a filial affection as motivating the fiduciary's assistance in making the purchase. Nor should the line be drawn with close relatives so as to exclude purchases by a close business asociate, such as Fribourg.[17] Such relationships commonly involve not only close ties of affection but also the expectation, if not specific understanding, of receiving reciprocal advantages for making available to the business associate investment opportunities which the fiduciary may regard himself, for one reason or another, as precluded from realizing.

We believe that the court below failed to recognize the importance of these factors in the context of this prophylactic rule. Certainly where, as here, claims are acquired on the basis of a fiduciary's information, and with his advice and assistance, and the relationship between the claimant

---

[17] This case does not present the problem of under what circumstances equitable sanctions should be imposed to discourage purchases by relatives or associates of the trustee in the absence of any evidence that the fiduciary advised or assisted in connection with such purchases. We believe that, as a minimum, the person whose close relationship to the fiduciary warrants an inference that he may have received inside information or assistance would have the burden of establishing the contrary.

and the fiduciary is such that an interest of the type discussed above must be presumed to exist,[18] all of the forces underlying the limitation-to-cost rule come into play. We submit that the rule can be effective only if the claimant in such cases is treated as standing in the shoes of the fiduciary, without regard to any active aiding, abetting or "confederating" on his part.[19] We believe that there is no hardship in making the acceptance by the third person of the gratuitous assistance from the fiduciary subject to the very same limitations with respect to realization of profit as if the fiduciary had traded for his own account.

---

[18] The court below apparently attributed no significance to the fact that all three claimants had been instrumental in securing control of the debtor by these directors through participation in loans to the debtor at the directors' request (R. 71-72; 178-179).

[19] Even if the sanction of the rule were made to depend upon some active participation by the relative or associate in a fiduciary's breach of trust, we believe that in this context it is a breach of trust upon the fiduciary's part to arrange or facilitate by relatives or business associates the purchases he is precluded from making for his own account, and that "knowing confederation" is involved in the acceptance of advice and tips from the person known to be an officer and a director. It is not necessary, we believe, that the recipient of advice also know that the corporation is insolvent, since in accepting the insider's tip or guidance he should be chargeable with all the information known to the insider—particularly where as in this case the price paid for the security is indicative of financial distress if not of actual insolvency.

CONCLUSION

For the above reasons the Commission submits that the decision of the court of appeals should be reversed.

Respectfully submitted,

PHILIP B. PERLMAN,
Solicitor General.

ROGER S. FOSTER,
General Counsel,

DAVID FERBER,
Special Counsel,

W. VICTOR RODIN,
GERALD W. SIEGEL,
Attorneys,
Securities and Exchange Commission.

OCTOBER 1949

☆ U. S. GOVERNMENT PRINTING OFFICE: 1949 [illegible] [illegible]